Bank of Botswana

Annual Report

2015

Board Members

(as at year-end 2015)

Linah K Mohohlo
Governor
(Chairman)

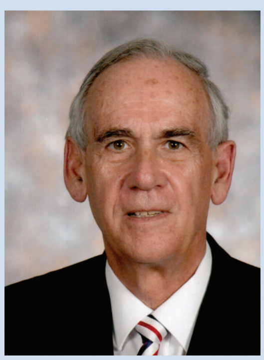
Gordon K Cunliffe

Solomon M Sekwakwa*

Caroline S Botlhole-Mmopi

Dr Joel Sentsho

Sir Paul Collier



Robert N Matthews

Dr Malebogo Bakwena

* Permanent Secretary, Ministry of Finance and Development Planning

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Boxes

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Abbreviations Used in the Report

AACB	–	Association of African Central Banks
AC	–	Audit Committee
AIDS	–	Acquired Immune Deficiency Syndrome
AfDB	–	African Development Bank
ATM	–	Automated Teller Machine
BAB	–	Bankers Association of Botswana
BACH	–	Botswana Automated Clearing House
BDC	–	Botswana Development Corporation
BEDIA	–	Botswana Export Development and Investment Authority
BIH	–	Botswana Innovation Hub
BIS	–	Bank for International Settlements
BISS	–	Botswana Inter-bank Settlement System
BITC	–	Botswana Investment and Trade Centre
BMC	–	Botswana Meat Commission
BNPC	–	Botswana National Productivity Centre
BoBCs	–	Bank of Botswana Certificates
BOCRA	–	Botswana Communications Regulatory Authority
BPC	–	Botswana Power Corporation
BSE	–	Botswana Stock Exchange
CCBG	–	Committee of Central Bank Governors
CEDA	–	Citizen Entrepreneurial Development Agency
CITS	–	Cheque Imaging and Truncation System
DBGSS	–	De Beers Global Sightholder Services
EDB	–	Ease of Doing Business
EDD	–	Economic Diversification Drive
EFT	–	Electronic Fund Transfer
ESP	–	Economic Stimulus Programme
FCA	–	Foreign Currency Account
FCI	–	Foreign Company Index
FDI	–	Foreign Direct Investment
GCI	–	Global Competitiveness Index
GDP	–	Gross Domestic Product
HIV	–	Human Immunodeficiency Virus
HRDC	–	Human Resources Development Council
ICT	–	Information and Communications Technology
IFSC	–	International Financial Services Centre
IFRS	–	International Financial Reporting Standards
IIP	–	International Investment Position
IMF	–	International Monetary Fund
ITP	–	Integrated Transport Project
KBAL	–	Kingdom Bank Africa Limited

LEA	–	Local Enterprise Authority
LF	–	Labour Force
LFPR	–	Labour Force Participation Rate
MDGs	–	Millennium Development Goals
MPS	–	Monetary Policy Statement
MoUs	–	Memoranda of Understanding
NDP	–	National Development Plan
NDBC	–	National Doing Business Committee
NEER	–	Nominal Effective Exchange Rate
NSO	–	National Strategy Office
OMO	–	Open Market Operations
OPEC	–	Organisation of Petroleum Exporting Countries
OPRC	–	Output and Performance Based Road Contracting
PEEPA	–	Public Enterprises Evaluation and Privatisation Agency
PPP	–	Public Private Partnership
PRR	–	Primary Reserve Requirement
REER	–	Real Effective Exchange Rate
REMCO	–	Remuneration Committee
RMB	–	Rand Merchant Bank
RMCI	–	Real Monetary Conditions Index
SA	–	South Africa
SACU	–	Southern African Customs Union
SADC	–	Southern African Development Community
SDDS	–	Special Data Dissemination Standard
SDG	–	Sustainable Development Goals
SDR	–	Special Drawing Rights
SEZ	–	Special Economic Zones
SIRESS	–	SADC Integrated Regional Settlement System
SMME	–	Small Micro and Medium-sized Enterprises
SPEDU	–	Selebi-Phikwe Economic Diversification Unit
SSKIA	–	Sir Seretse Khama International Airport
SSA	–	Sub-Saharan Africa
SWIFT	–	Society for Worldwide Interbank Financial Telecommunication
TFP	–	Total Factor Productivity
UK	–	United Kingdom
UMIC	–	Upper Middle-Income Country
UNICEF	–	United Nations Children's Emergency Fund
USA	–	United States of America
USD	–	United States Dollar
VAT	–	Value Added Tax
WEF	–	World Economic Forum
WEO	–	World Economic Outlook
WUC	–	Water Utilities Corporation
WTO	–	World Trade Organisation

Part A

Statutory Report on the Operations and Financial Statements of the Bank for 2015

Bank of Botswana

Senior Management as at December 31, 2015

Deputy Governors

Oduetse A Motshidisi

Moses D Pelaelo

General Manager

Richard H Nlebesi

Heads of Department

Andrew M Motsomi
Banking Supervision

Julius Ghanie
Information Technology

Ewetse T Rakhudu
Payments & Settlement

Ralesedi E Somolekae
Human Resources

Dr Kealeboga S Masalila
Monetary & Financial Stability

Pelani D Siwawa-Ndai
Secretariat

Daniel N Loeto
Finance

Sholo A Matale
Banking & Currency

Sheila M Sealetsa
Financial Markets (Ag.)

GOVERNOR'S FOREWORD

The *Annual Report* for 2015 is published in accordance with Section 68(1) of the Bank of Botswana Act (CAP 55:01). As a statutory requirement, the *Report* presents the Bank's operational activities and financial performance for the review period.

However, the *Report* also covers the Bank's delivery on other mandates, especially the conduct of monetary policy; implementation of the exchange rate policy; management of foreign exchange reserves; regulation and supervision of banks; oversight of the payments systems; and monitoring as well as fostering of financial stability.

A theme topic, *Employment Opportunities, Productivity and Competitiveness as Contributors to Sustainable Economic Growth: Botswana's Case*, is included. The topic analyses the challenges of, and suggests policy options for, supporting economic diversification, creation of employment and raising living standards.

Although the Bank had overall good operational results and achieved its policy objectives during 2015, the domestic and external environment was less favourable than was the case the previous year. Global economic activity was sluggish with mixed regional performances and uncertain prospects. Economic growth strengthened marginally in advanced economies, led by the United States of America, while the Eurozone and Japanese economies expanded at much slower rates. Moreover, an overall robust output growth for emerging market countries was weighed down by the slowdown in the Chinese economy and the impact of falling demand on commodity-dependent economies. Inflationary pressures remained generally benign, as reinforced by a further decline in international oil and food prices that threatened deflation and recovery in some countries. For Botswana, non-mining output rose moderately. However, overall economic growth was constrained by a contraction of mining production, together with the impact of continued power and water shortages.

With regard to financial performance, the Bank's total assets rose by P5.7 billion to P85.4 billion of which the foreign exchange reserves were P84.9 billion in December 2015. The reserves were equivalent to 18.3 months of imports of goods and services. The higher level of foreign exchange reserves was the result of currency and market valuation gains, as weakening demand for exports resulted in a small overall balance of payments deficit of P57 million. The Bank's net income for the year improved significantly to P9.1 billion, from P4.1 billion in 2014. After transferring non-distributable currency gains of P6.9 billion to the Currency Revaluation Reserve, the net distributable income of P2.3 billion was slightly lower than the P2.4 billion of 2014.

Domestic inflation fell from 3.8 percent in December 2014 to 3.1 percent at year-end 2015. For more than a year and half, inflation fell within the 3-6 percent desired medium-term objective range.[1] This outturn was a combined result of low global inflation, particularly in Botswana's trading partner countries, the absence of major upward adjustments to administered prices, subdued domestic economic growth and the impact of monetary policy on demand.

In the light of the positive medium-term inflation outlook, the Bank Rate was reduced by 1.5 percentage points to 6 percent during the year. Bank lending was also encouraged by limiting excess liquidity absorption through Bank of Botswana Certificates auctions to P5 billion. In addition, pressure on bank liquidity in the early part of the year was eased by reducing the Primary Reserve Requirement on Pula-denominated deposits from ten percent to five percent, effective April 1, 2015.

1 Inflation fell below the objective range several times in 2015, largely reflecting a decrease in fuel prices.

The banking industry remained robust, well capitalised and met minimum prudential requirements, notwithstanding overall marked decline in profitability compared to the prior year. This was as a result of a decline in net interest margins as lending rates fell while deposit rates were relatively stable. The Bank revoked the banking licence of Kingdom Bank Africa Limited (offshore bank) after it was assessed to be insolvent; the bank is now in liquidation.

The banking sector's balance sheet increased by 12.6 percent to P68 billion. Even so, credit growth slowed from 13.5 percent in 2014 to 7.1 percent in 2015 due to a contraction in lending to businesses, a development which reflected an overall decline in business confidence and outlook. In contrast, borrowing by households accelerated from 10.7 percent to 12.8 percent. Nevertheless, the increase in growth of household credit was consistent with maintenance of financial stability.

Export competitiveness continued to be supported by the zero rate of crawl of the Pula as domestic inflation was comparable to the average price increase in trading partners. As a result, the real effective exchange rate was stable throughout the year. Bilaterally, however, the Pula appreciated by 11.4 percent against the South African rand and depreciated against the United States dollar (13.3 percent) and the other SDR currencies.

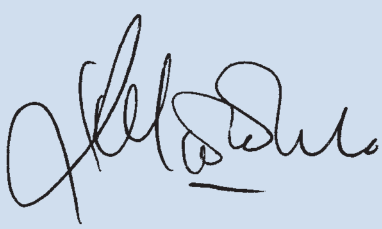
Botswana's investment grade credit ratings were retained by both Moody's Investors Service and Standard & Poor's. The ratings affirmed the Government's strong financial position as underpinned by prudent macroeconomic policies and a favourable external position. However, both rating agencies reiterated the longstanding concern about the country's slow pace of economic diversification.

The efficiency of the national and international payments system was enhanced with the commencement of operations of the Botswana Automated Clearing House and approval for Botswana's participation in the SADC's Integrated Regional Settlement System. Various programmes of skills development and staff welfare continued to be implemented to buttress the Bank's operational efficiency and productivity.

In fulfilment of statutory obligations, the Bank's Annual Report and Banking Supervision Annual Report for 2014 were submitted to the Minister of Finance and Development Planning on March 31 and June 30, 2015, respectively. The Bank also continued to publish the monthly Botswana Financial Statistics, the biannual Business Expectations Survey and the Research Bulletin.

External and public relations activities were maintained throughout the year as part of the Bank's fulfilment of its accountability obligations. This included economic briefings, consultations with relevant international bodies and institutions as well as attendance of meetings of the Association of African Central Banks, Committee of SADC Central Bank Governors, International Monetary Fund and Bank for International Settlements.

As in previous years, the Bank owes a debt of gratitude to the Board for the guidance and support in implementing the 2015 work programme. It is hoped that stakeholders will find the 2015 *Annual Report* informative.



Linah K Mohohlo

GOVERNOR

STATUTORY REPORT ON OPERATIONS AND FINANCIAL STATEMENTS OF THE BANK – 2015

The Bank's Mission and Objectives

The mission and primary objectives of the Bank, as stipulated in Section 4 (1) of the Bank of Botswana Act (CAP 55:01), are to:

- promote and maintain monetary stability; this primarily requires the maintenance of a low, predictable and sustainable level of inflation;
- ensure that the overall financial system is safe and sound;
- regulate and oversee the payments system and ensure that it is secure and efficient; and
- in so far as it would not be inconsistent with monetary stability, promote the orderly, balanced and sustainable economic development of the country.

Figure 1 shows the strategies, activities and supportive infrastructure that are utilised to achieve the Bank's mission and objectives. Monetary stability is attained through the formulation and implementation of monetary policy. Banks are regulated and supervised to foster operational safety and soundness. Financial sector vulnerability assessment and performance monitoring are carried out to promote financial stability. Currency management and facilitation of payments systems enable the flow of payments and settlement. Moreover, oversight and regulation entrenches confidence in the payments and settlement system and mitigates systemic risks. The Bank provides banking services to the Government, commercial banks and selected public institutions. The Bank also implements the exchange rate policy and manages the country's foreign exchange reserves as an agent of Government. The management of foreign exchange reserves enables the country to meet international financial obligations. Furthermore, the Bank provides advice to Government on macroeconomic and financial policy matters. The governance structure coordinates and creates synergies between policy-oriented activities and support services, including human resource management and training, adoption of efficiency-enhancing technology, risk management, creating a culture of good conduct, staff discipline and adherence to institutional values.

Governance and Organisational Structure

The Board is at the apex of the governance structure of the Bank and has two committees, the Audit Committee (AC) and the Remuneration Committee (REMCO) that are chaired by non-executive board members. The Governor is chairman of the Board and Chief Executive Officer of the Bank (consistent with practice in many other central banks[2]), overseeing nine Departments and four Divisions; supported by two Deputy Governors and General Manager (Figure 2).

Board Functions, Membership and Appointments

The Board oversees and guides the Bank's general strategic direction and operations in accordance with the Bank of Botswana Act and Bye-Laws. It comprises two ex-officio members, the Governor and Permanent Secretary of the Ministry of Finance and Development Planning as well as seven other members who are appointed by the Minister of Finance and Development Planning in their individual capacity, two of whom may be public officers. The Governor and the two (non-Board members) Deputy Governors are appointed by the President. The Audit Committee and Remuneration Committee consider issues pertaining to their respective

2 This practice is found at the Federal Reserve Bank of the USA, the European Central Bank, Bank of Canada, Reserve Bank of Australia, other developed country central banks and those for the SADC region.

Figure 1: Mission, Objectives, Strategies and Supportive Structures

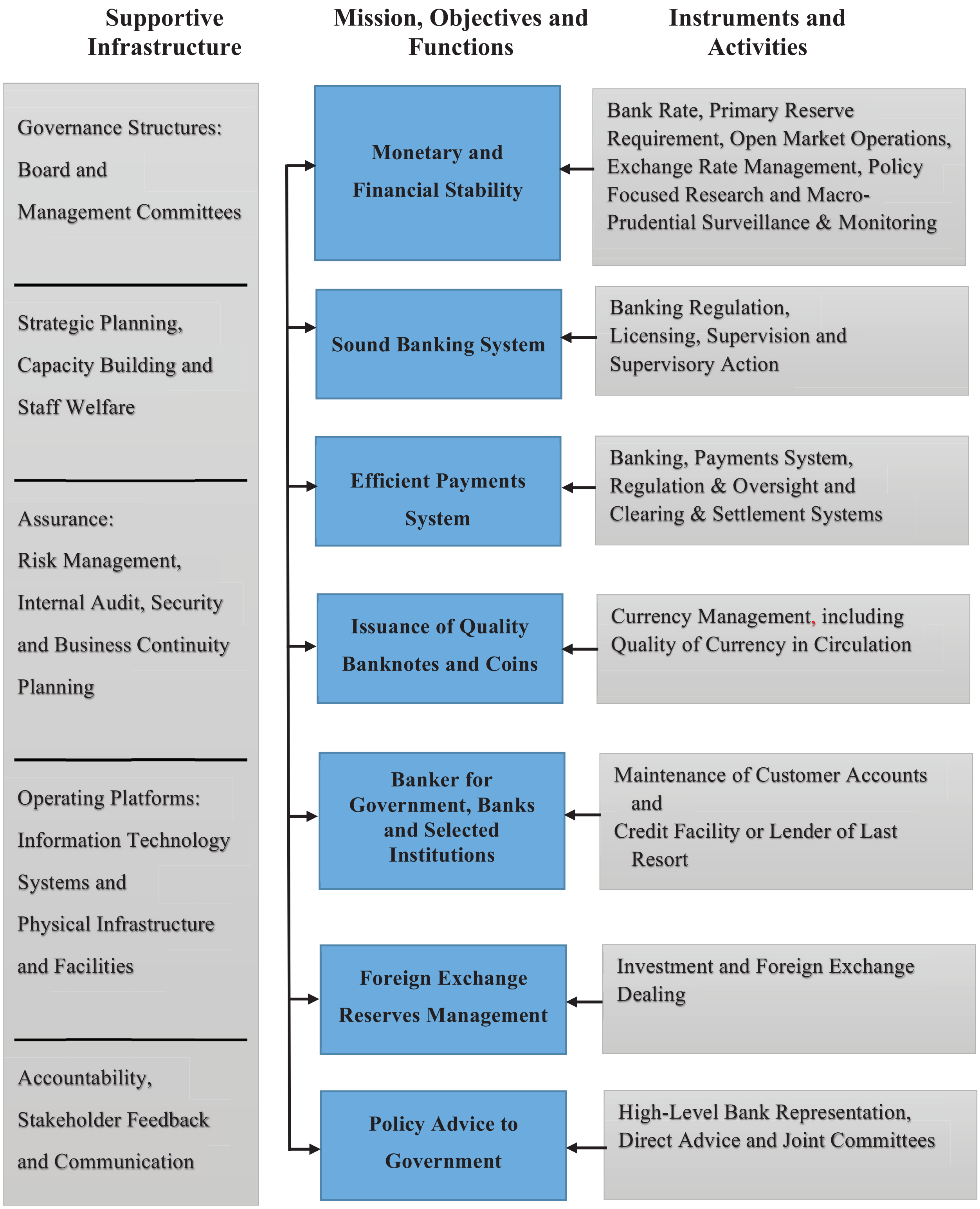
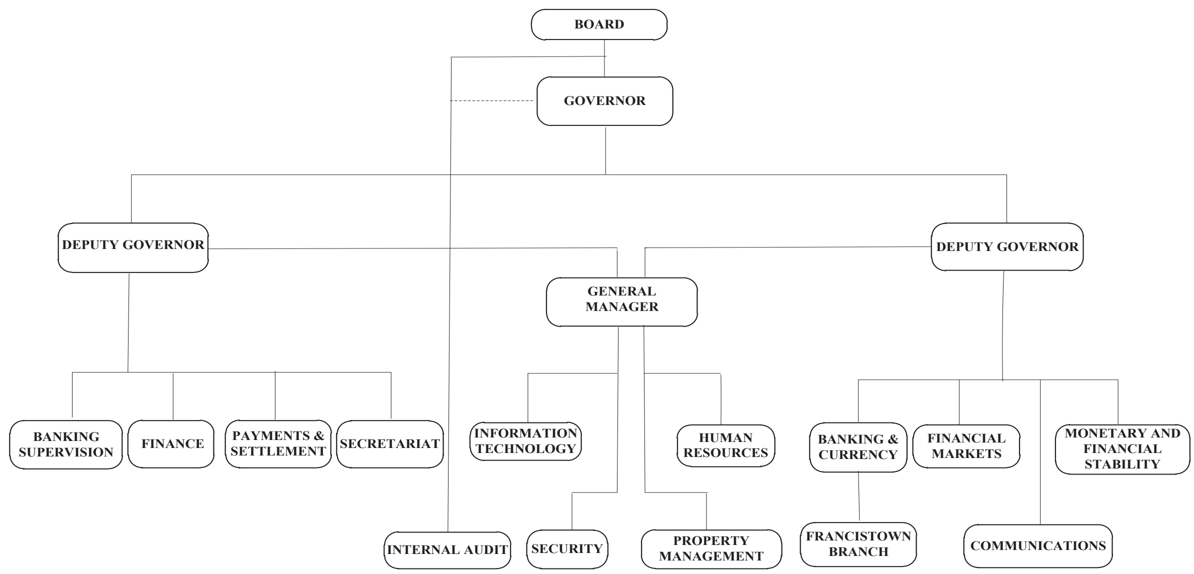


FIGURE 2: GOVERNANCE AND ORGANISATION STRUCTURE AS AT DECEMBER 31, 2015



Source: Bank of Botswana

TABLE 1: BOARD MEETINGS AND ATTENDANCE IN 2015

Meeting	L K Mohohlo (Chairman, Board)	S Sekwakwa (Ex-officio)	G K Cunliffe (Chairman, AC)	R N Matthews (AC)	C S Botlhole-Mmopi (AC)	J Sentsho (REMCO)	P Collier (REMCO)	M Bakwena (Chairman, REMCO)
BB 1/15 (Feb 20)	✓	×	✓	✓	✓	✓	×	✓
BB 2/15 (Mar 27)	✓	✓	✓	✓	×	✓	✓T	✓
BB 3/15 (Jun 19)	✓	×	✓	✓	×	×	✓	✓
BB 4/15 (Aug 18)	✓	✓	✓	×	✓	✓	×	✓
BB 5/15 (Oct 20)	✓	×	×	✓	✓	✓	×	✓
BB 6/15 (Dec 11)	✓	✓	✓	✓	✓	×	×	✓

Key: ✓ Attended
× Not attended
T Participation through video and teleconferencing
BB Board Meeting

Source: Bank of Botswana

mandates and make recommendations to the Board. Six Board meetings were held during the year (Table 1). At year-end, the Board had one vacancy.

Governor, Deputy Governors and General Manager

The Governor implements Board decisions and submits the *Annual Report* on the operations and financial performance (including audited financial statements) of the Bank to the Minister of Finance and Development

Planning within three months of the end of the financial year as stipulated in the Bank of Botswana Act. In turn, the Minister presents the *Annual Report* to Parliament within 30 days following receipt of the Report. The *Banking Supervision Annual Report* is submitted to the Minister by the end of June each year. The Governor represents the Bank at relevant local, regional and international meetings, and is the country's representative on the Board of Governors of the International Monetary Fund (IMF).

Executive Committee

The Executive Committee is chaired by the Governor and comprises Deputy Governors, the General Manager and Heads of Department. Senior advisors may be co-opted as members. The Committee meets once a week to monitor and review the implementation of the Bank's work programme.

Departments and Divisions

The Bank has nine departments, five of which are policy departments that fulfil the Bank's core mandates, while four departments provide auxiliary support and corporate services. The Monetary and Financial Stability Department undertakes data collection, research, macroeconomic analysis, monitors the financial sector and evaluates emerging risks and other developments emanating from the macroeconomic environment. The Department also conducts macro-prudential assessments, and facilitates coordination with other relevant external entities to ensure macroeconomic and financial stability. Furthermore, the Department undertakes macroeconomic forecasting and policy review in support of the Bank's conduct of monetary policy and implementation of the exchange rate policy. Production and dissemination of the Bank's *Annual Report* and other publications are also the responsibility of the Monetary and Financial Stability Department.

The Banking and Currency Department is responsible for procurement, management, custody and issuance of the national currency. The Department also provides banking services to the Government, commercial banks and selected institutions. It is a repository for the country's financial relations with the IMF and African Development Bank.

The Banking Supervision Department licences, regulates and supervises banks and other financial institutions that fall under the Bank's regulatory and supervisory purview and publishes the *Banking Supervision Annual Report.* The oversight and regulation of payments and settlement transactions is carried out by the Payments and Settlement Department, while the Financial Markets Department is responsible for the management of foreign exchange reserves, foreign exchange dealing, open market operations and other money and capital market activities, which include issuance of government bonds and treasury bills.

The Finance Department is responsible for accounting and reporting on the Bank's financial activities, including production of monthly and annual financial statements of the Bank, in accordance with the Bank of Botswana Act and International Financial Reporting Standards (IFRS). The Department also coordinates strategic planning, formulation and implementation of risk management and business continuity management. The Human Resources Department is responsible for staff recruitment, training, remuneration and welfare, while the Information Technology Department ensures that the Bank's information technology systems and infrastructure are robust and effective in meeting the needs of the Bank.

The Secretariat serves the Board and Executive Committee and discharges related support functions. It is also responsible for the library, records management and protocol services. Other support services are undertaken through the specialised activities of four divisions, Internal Audit, Security, Communications and Property Management. The Internal Audit Division ensures that the Bank's operations are sound and comply with established financial and operational controls as well as governance structures, in line with the Bank of Botswana Act and international best practice. The Security Division has the primary responsibility of managing all safety and security-related risks within the Bank and ensures the security of all Bank properties. The Communications Division coordinates communications activities in relation to media and effective transmission of information on the Bank's mandate, policies and practices to stakeholders in a timely, efficient and effective manner. The Division also coordinates the Bank's Public Education Programme and policies with the aim of promoting financial literacy and improving public understanding of the Bank's role in economic development of the country. The Property Management Division undertakes procurement, custody and maintenance of immovable and movable assets, including the Bank's real estate and related equipment.

Review of the Bank's main activities in 2015

Monetary Policy, Money and Capital Market Activities and Exchange Rate Policy

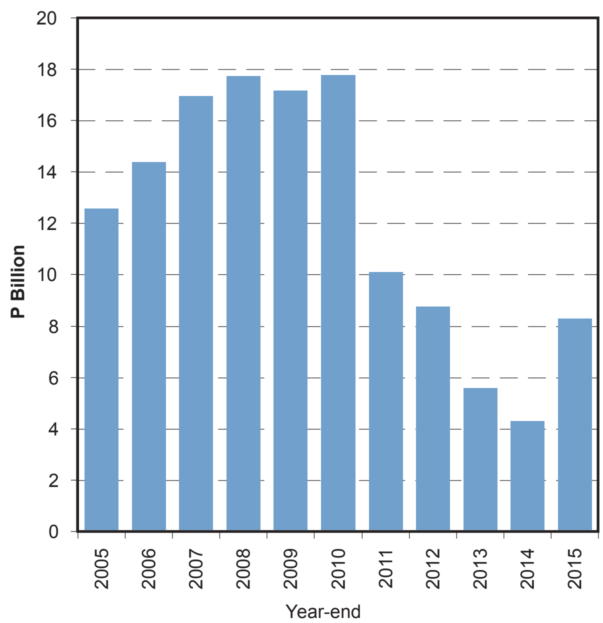
Monetary Policy

The 2015 Monetary Policy Statement (MPS) and the Mid-Term Review retained the Bank's medium-term inflation objective of 3 – 6 percent. In 2015, monetary policy was conducted in the context of a positive medium–term inflation outlook. Inflation fluctuated around the lower bound of the Bank's 3 – 6 percent objective range throughout the year due to modest domestic demand, reasonable upward adjustment in administered prices and government levies, as well as benign foreign price developments. In view of the positive inflation outlook and in order to support economic growth, the Bank Rate was reduced by a cumulative 1.5 percentage points from 7.5 percent to 6 percent during the year. The conduct of monetary policy also took into consideration the need to maintain financial stability. Among others, the relevant considerations relate to liquidity developments, credit dynamics (expansion and default rates) relative to economic activity (including property market developments) and growth in incomes, as well as financial sector performance.

Money and Capital Markets

Monetary policy was implemented using open market operations (OMO) to absorb excess liquidity and establish interest rates at levels that were consistent with the policy stance. The outstanding value of Bank of Botswana Certificates (BoBCs) increased from P4.2 billion at the end of 2014 to P8.2 billion in December 2015 due to the increase in excess liquidity.[3] Repurchase Agreements (repos) and reverse repos were used during the year to manage liquidity between auctions, with the result that P1.7 billion worth of reverse repos was outstanding at the end of 2015 compared to P0.56 billion in December 2014. As at the end of 2015, there were no outstanding repos (Table 2 and Chart 1).

Chart 1: Bank of Botswana Certificates 2005 – 2015



Source: Bank of Botswana

The 14-day BoBC weighted average yield decreased substantially from 3.07 percent in December 2014 to 0.97 percent in December 2015, while the yield on the 91-day BoBC eased from 3.19 percent to 1.17 percent in the same period. The average prime lending rate for commercial banks decreased from 9 percent in 2014 to 7.5 percent in 2015, thus reflecting the Bank's decision to reduce the Bank Rate by a cumulative 1.5 percentage points during the year. Meanwhile, the nominal 3-month

3 The increase in excess liquidity resulted from the reduction of the primary reserve requirement (intended to address tight liquidity experienced earlier in 2015), growth in deposits at commercial banks (notably, placement by the Botswana Public Officers Pension Fund) and expansion in government spending including lending to parastatals.

Table 2: Money Market 2014 - 2015

	End-2014			End-2015		
	Outstanding balances[2] (P Billion)	Interest rate (Percent)[1] Nominal	Real	Outstanding balances[2] (P Billion)	Interest rate (Percent)[1] Nominal	Real
6-month Treasury Bills[1,3]	0.54	3.25	-0.53	0.84	1.61	-1.45
14-day BoBCs[1]	0.85	3.07	-0.70	4.2	0.97	-2.07
91-day BoBCs[1]	3.36	3.19	-0.59	4.0	1.17	-1.87
Reverse repos	0.56	3.00	-0.77	1.7	1.50	-1.55
Repos	0	7.00	3.08	0	5.50	2.33
88-day deposits	4.40	2.67	-1.09	10.9	2.50	-0.58
Prime rate		9.00	5.01		7.50	4.27

1. Stop-out yield is used for Treasury Bills, while weighted average yield is used for both the 14-day and 91-day BoBC yields.
2. Book value
3. Original date to maturity

Source: Bank of Botswana

deposit interest rate decreased from 2.67 percent in December 2014 to 2.5 percent at the end of 2015 (Table 2). As directed by the Bank, commercial banks continued to offer and advertise the 91-day deposit facility or equivalent deposit product which pays an interest rate that, at a minimum, is the prevailing Bank Rate less 3.5 percentage points.[4] The expectation is that longer-dated deposits were earning higher levels of interest rates. Real interest rates on deposits generally increased due to lower inflation in 2015 and were positive for longer-dated deposits.

The P15 billion Government Bond Programme remains in place, with the focus on the development of the capital market, while also providing an alternative source of government funding. BW003 matured on October 31, 2015 and released P1.6 billion into the market, although a substantial part of it was absorbed in the subsequent auction such

Table 3: Government Bonds and Treasury Bills 2014 - 2015

	End 2014			End 2015		
Bond Code[4]	Outstanding (P Million)[1,2]	Market Yields³ (Percent) Yield	Real	Outstanding (P Million)[1,2]	Market Yields³ (Percent) Yield	Real
6-month Treasury Bills	540	3.25	-0.53	840	1.61	-1.45
BW003 (31/10/2015)	1 642	3.97	0.16	–	–	–
BW010 (14/03/2017)	718	4.52	0.69	718	3.54	0.43
BW005 (12/09/2018)	1 233	4.78	0.94	1 338	3.83	0.71
BW008 (08/09/2020)	933	5.35	1.49	1 083	4.59	1.45
BW007 (10/03/2025)	1 295	5.83	1.96	1 410	4.96	1.80
BW011 (10/09/2031)	870	6.28	2.39	1 370	5.52	2.35
BW012 (13/06/2040)		–	–	437	5.86	2.68
	7 231			**7 196**		

1. Where outstanding values differ for the same bond code between the two years, it means the bond was reopened for issuing an additional amount.
2. Book value.
3. Indicative yields.
4. Maturity dates are in parentheses.

Source: Bank of Botswana

4 Given the Bank Rate of 6 percent, the minimum deposit interest rate was 2.5 percent for the 91-day and equivalent deposit facilities.

that outstanding bonds of various maturities and Treasury Bills declined marginally in 2015 (Table 3). Meanwhile, the Bank held P20 million (0.28 percent) of the total outstanding securities for possible repo transactions.

Exchange Rate Policy

The Bank implemented a zero rate of crawl of the composite exchange rate, while the Pula basket weights were adjusted to 50 percent each for the South African rand and SDR. In the twelve months to December 2015, the trade weighted nominal effective exchange rate (NEER) of the Pula was stable due to the zero rate of crawl of the Pula exchange rate mechanism; the REER was similarly stable due to the small difference between inflation in Botswana and in her trading partner countries. The sustained relative stability of the REER supported the competitiveness of local producers of tradeable goods and services, thereby contributing to the national objective of economic diversification and associated industrial development and employment creation.

Regulation and Supervision of Banks and Bureaux de Change

In the period ended December 31, 2015, the banking sector was well capitalised and liquid. The sector's compliance with the regulatory and prudential requirements was considered satisfactory as shown in Table 4. However, profitability was subdued with one bank recording a loss.

TABLE 4: FINANCIAL SOUNDNESS INDICATORS AND RANGE OF PRUDENTIAL STANDARDS[1] FOR LICENSED BANKS (2012 – 2015)

	Prudential	Range of Prudential Standard for Local Banks (Percent)			
	Standard	2012	2013	2014	2015
Capital Adequacy	≥15	17.3 - 24.2	16.2 - 24.3	16.1 - 23.1	15.9 - 24.2
Liquid Asset Ratio	≥10	12.4 - 51.4	12 – 36	10.5 – 19.6	13.1 – 33.1
Profitability (Return on assets)	Positive	0.8 - 4.5	0.7 – 4	0.2 – 3.8	(0.4) – 2.6
Profitability (Return on equity)	Positive	9.2 – 39.1	6 – 32	2.1 – 27.7	(6.2) – 21.4
Asset quality (Non-performing Loans/Total Loans)	≤2.5	1.7 - 14.4	0.6 – 11.6	0.6 – 11.8	0.4 – 8.4
Intermediation (Advances/Deposits)	50 - 80	52.5 - 84.4	63 – 86	68.7 – 94.9	65.6 – 93.1

1. Ratios exclude newly licensed banks.
Source: Bank of Botswana

The two-year freeze on upward adjustment of bank charges and fees imposed by the Bank effective January 1, 2014 ended on December 31, 2015. The Capital Directive on the Revised International Convergence of Capital Measurement and Capital Standards for Botswana (Basel II) and the related guidelines were issued to banks for implementation effective January 1, 2016. In an effort to enhance home-host supervisory relations, the Bank finalised and signed Memoranda of Understanding (MoUs) with the Reserve Bank of India and Reserve Bank of Malawi.

An appeal on a banking licence rejected by the Bank was lodged with the Ministry of Finance and Development and was unsuccessful. Furthermore, a conditional approval for a banking licence granted in 2014 was revoked due to lack of progress in the fulfilment of the stipulated conditions. The applicant proceeded to lodge an appeal with the Minister of Finance and Development Planning, who upheld the Bank's revocation decision. A total of seven bureaux de change were licensed, while four had their licences revoked for failure to comply with the regulations. Two bureaux de change surrendered their licences after failing to commence operations. The total number of operating bureaux de change was 57 as at December 31, 2015 compared to 56 in the prior year.

Banks continued to restructure and rationalise their operations to improve efficiency. This resulted in the closure of three branches and five Automated Teller Machines (ATMs). The total number of commercial bank branches and ATMs as at December 31, 2015, was 111 and 415, respectively, which is a decrease from 114 and 420 as at December 31, 2014, respectively.

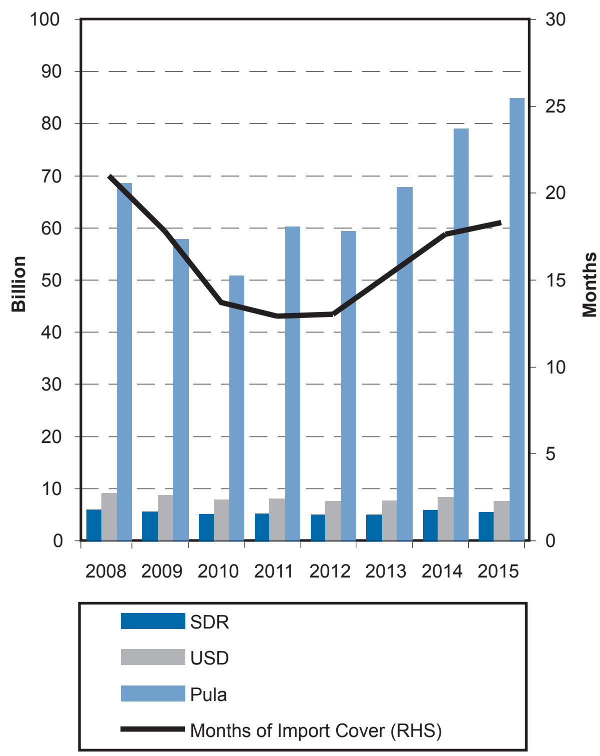
Abandoned funds continued to be administered in accordance with Section 39 of the Banking Act (CAP. 46.04). As at December 31, 2015, these funds amounted to P5.5 million (P5.1 million in December 31, 2014). Claims for the year amounted to P509 801, while P1.4 million was transferred to the Guardian Fund.

The Bank revoked the banking licence of Kingdom Bank Africa Limited (KBAL), after it was assessed to be insolvent; it is now in liquidation.

Foreign Exchange Reserves Management

Foreign exchange reserves increased by 7.3 percent from P79.1 billion in December 2014 to P84.9 billion as at the end of December 2015. The increase in reserves reflects valuation gains despite net foreign exchange outflows. In US dollars terms, the reserves decreased by 9.3 percent from USD8.3 billion in December 2014 to USD7.5 billion as at the end of December 2015, while it decreased by 5.3 percent in SDR terms from SDR5.8 billion to SDR5.4 billion in the same period. In terms of months of import cover, the reserves were equivalent to 18.3 months in December 2015, up from 17.6 months in December 2014 (Chart 2).

Chart 2: Foreign Exchange Reserves



Source: Bank of Botswana

Currency Operations

The number of banknotes in circulation increased by 8.3 percent in 2015, mainly due to the increase in the net issuance of the P20 and P10 banknote denominations, which increased by 17.8 percent and 19.4 percent, respectively. This shows a high demand for these denominations during the period under review, with a share of total issuance of 23.1 percent and 14.9 percent from 21.3 percent and 13.5 percent, respectively, recorded in 2014. The P200 denomination continued to have the highest share of total issuance at 29.7 percent.

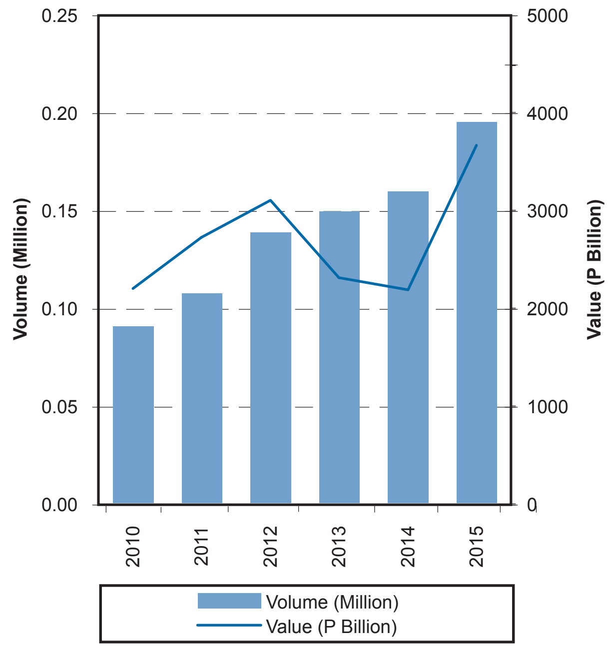
The net issuance of all coin denominations increased by 10.4 percent in 2015 compared to an increase of 31.7 percent in 2014. The relatively low net issuance in 2015 was attributable to sufficiency of coin issued into the market and the fact that coin is exchanged at commercial banks and not ordinarily returned to the Bank of Botswana.

Payments and Settlement

The National Payments System landscape continued to evolve, as evidenced by an increase in participants, new payment methods and technological developments. Consistent with its oversight responsibilities, the Bank continued to foster and monitor these developments.

The Botswana Automated Clearing House (BACH) was commissioned in February 2015, enabling the banks to reduce the cheque clearing cycle to two days, with an interface with the Botswana Inter-bank Settlement System (BISS) to facilitate collateralisation of transactions and guarantee settlement finality. Charts 3 - 5 show transactions effected through the BISS and electronic clearing house through electronic funds transfer and cheque transactions, respectively, over the years. In addition, approval was granted for Botswana to participate in the SADC Integrated Regional Settlement System (SIRESS), a facility that promotes intra-regional trade and investment.

CHART 3: BOTSWANA INTER-BANK SETTLEMENT SYSTEM (BISS) TRANSACTIONS (2010 - 2015)



Source: Bank of Botswana

Information Technology

The Bank's computing and information systems continue to be upgraded in line with innovation and technological advancements and in order to meet evolving functional and strategy requirements, while also allowing for effective connectivity with respect to external relationships.

Human Resources, Staff Welfare and Staff Pension Fund

Human Resources and Staff Welfare

As at December 31, 2015, the Bank's Staff Establishment was 593. The vacancy level stood at 9.4 percent, up from 9.1 percent in 2014. Twenty new staff joined the Bank, while 19 terminated employment. The Bank continues to place emphasis on staff development and, in this regard, several staff members benefited from both short and long-term training.

CHART 4: ELECTRONIC CLEARING HOUSE: CHEQUE PROCESSING (2010 - 2015)

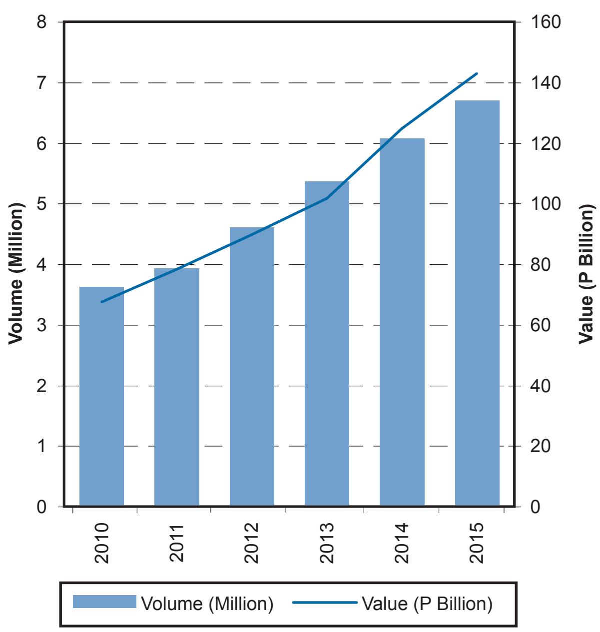
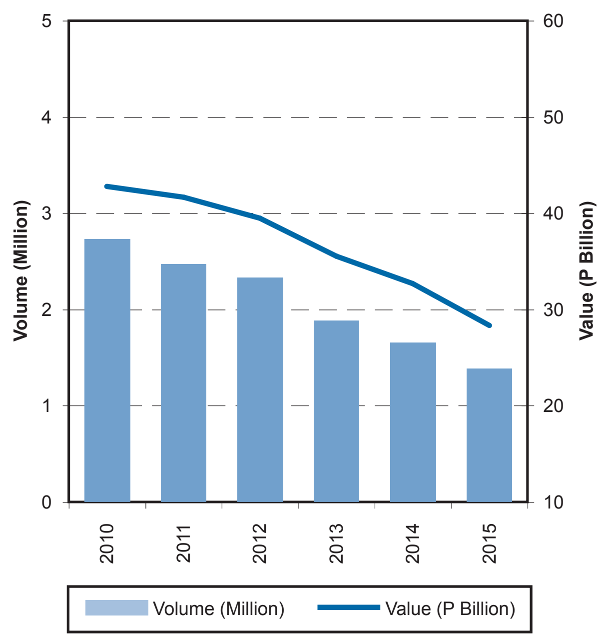


CHART 5: ELECTRONIC CLEARING HOUSE: ELECTRONIC FUNDS TRANSFERS (2010 - 2015)



Source: Bank of Botswana

Staff Pension Fund

The Bank of Botswana Defined Contribution Staff Pension Fund declared an investment return for the year ended September 30, 2015, of 11.42 percent and 10.86 percent compared to the 2014 declared return of 21 percent and 20.44 percent for the active and deferred members, respectively.

External Relations and Communication

External Relations

The Bank participated in relevant regional and international meetings as well as hosting consultation, surveillance and technical assistance missions. The Bank also took part in meetings and conferences organised by the World Economic Forum, Bank for International Settlements (BIS), World Bank and International Monetary Fund (IMF). At a regional level, the Bank participated in meetings organised by Southern African Customs Union (SACU), SADC Committee of Central Bank Governors (CCBG) and the Association of African Central Banks (AACB). In addition, the Bank hosted the international sovereign credit rating agencies, Moody's Investors Service and Standard & Poor's, as they conducted the annual review of the credit ratings.

Publications, Communications and Public Education

In accordance with statutory requirements, the 2014 Annual Report on the Bank's operations and financial statements and the 2014 Banking Supervision Annual Report were submitted to the Minister of Finance and Development Planning on March 31, 2015 and June 30, 2015, respectively. The 2015 Monetary Policy Statement (and Mid-Term Review), monthly Botswana Financial Statistics and Research Bulletin were also published, while the Bank's website provided timely access to data, publications, press releases and the Bank's policies.

In fulfilment of accountability and transparency principles of governance, and in implementation of the public outreach programme, the Bank conducted economic briefings following the publication of the 2014 Annual Report. Among the key stakeholders who attended the briefings were the Cabinet, heads/representatives of diplomatic missions, heads of public and private sector institutions, senior government officials and the media.

ANNUAL FINANCIAL STATEMENTS

2015

BANK OF BOTSWANA

STATEMENT OF RESPONSIBILITY OF THE BOARD AND APPROVAL OF THE ANNUAL FINANCIALSTATEMENTS

The members of the Board are responsible for the preparation and fair presentation of the annual financial statements of the Bank, comprising the Statement of Financial Position at December 31, 2015, Statement of Profit or Loss and Other Comprehensive Income, Statement of Distribution, Statement of Cash Flows and Statement of Changes in Shareholder's Funds for the year then ended, and the notes to the financial statements which include a summary of significant accounting policies and other explanatory notes, in accordance with International Financial Reporting Standards, and in the manner required by the Bank of Botswana Act (CAP 55:01).

The members are also responsible for such internal control as the members determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and for maintaining adequate accounting records and an effective system of risk management.

The Board members have made an assessment of the ability of the Bank to continue as a going concern and have no reason to believe that the Bank will not be a going concern in the year ahead.

The auditor is responsible for reporting on whether the annual financial statements are fairly presented in accordance with the applicable financial reporting framework.

Approval of Annual Financial Statements

The annual financial statements of the Bank, as identified in the first paragraph, were approved by the Board on March 24, 2016 and signed on behalf of the Board by:

Linah K Mohohlo

Governor

Gordon K Cunliffe

Board Member

(Audit Committee Chairman)

KPMG

KPMG, Chartered Accountants
Audit
Plot 67977, Off Tlokweng Road,
Fairground Park
PO Box 1519, Gaborone, Botswana

Telephone +267 391 2400
Fax +267 397 5281
Web http://www.kpmg.com/

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF THE BOARD OF BANK OF BOTSWANA

We have audited the financial statements of the Bank of Botswana, which comprise the Statement of Financial Position at December 31, 2015, Statement of Profit or Loss and Other Comprehensive Income, Statement Of Distribution, Statement of Cash Flows and Statement of Changes in Shareholder's Funds for the year then ended and the notes to the financial statements which include a summary of significant accounting policies and other explanatory notes as set out on pages 31 to 63.

Board Members' Responsibility for the Financial Statements
The members of the Board are responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and in the manner required by the Bank of Botswana Act (CAP 55:01), and for such internal control as the members determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility
Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements, plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion
In our opinion, these financial statements give a true and fair view of the financial position of Bank of Botswana at December 31, 2015 and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards, and in the manner required by the Bank of Botswana Act (CAP 55:01).

KPMG
Certified Auditors
Practising Member: A.G Devlin (19960060.23)

Gaborone
March 24, 2016

STATEMENT OF FINANCIAL POSITION
December 31, 2015

	Notes	2015	2014
		P'000	P'000
ASSETS			
Foreign Assets			
Liquidity Portfolio	1.1	21 914 420	22 723 901
Pula Fund	1.2	61 183 450	54 757 524
International Monetary Fund (IMF)			
Reserve Tranche	2.1	424 539	430 044
Holdings of Special Drawing Rights	2.2	1 334 931	1 178 929
General Subsidy Account	2.3	23 666	20 907
Total Foreign Assets		84 881 006	79 111 305
Domestic Assets			
Property and Equipment	3	403 770	413 618
Government of Botswana Bond	4	23 733	24 137
Other Assets	5	122 604	140 821
Total Domestic Assets		550 107	578 576
TOTAL ASSETS		85 431 113	79 689 881
LIABILITIES AND SHAREHOLDER'S FUNDS			
Foreign Liabilities			
Allocation of IMF Special Drawing Rights	6	893 912	789 694
Liabilities to Government (IMF Reserve Tranche)	7	358 931	364 435
Total Foreign Liabilities		1 252 843	1 154 129
Domestic Liabilities			
Notes and Coin in Circulation	8	2 707 835	2 598 609
Bank of Botswana Certificates	9	8 189 922	4 201 384
Reverse Repurchase Agreements	9.1	1 672 849	304 357
Deposits	10	5 067 372	6 841 828
Dividend to Government	11	401 782	544 689
Other Liabilities	12	129 509	214 974
Total Domestic Liabilities		18 169 269	14 705 841
Total Liabilities		19 422 112	15 859 970
Shareholder's Funds			
Paid-up Capital	14	25 000	25 000
Government Investment Account			
Pula Fund and Liquidity Portfolio		35 504 942	37 260 622
Currency Revaluation Reserve		23 911 754	19 728 010
Market Revaluation Reserve		4 967 305	5 216 279
General Reserve	15	1 600 000	1 600 000
Total Shareholder's Funds		66 009 001	63 829 911
TOTAL LIABILITIES AND SHAREHOLDER'S FUNDS		85 431 113	79 689 881
FOREIGN ASSETS IN US DOLLARS (000)[1]		7 545 921	8 322 509
FOREIGN ASSETS IN SDR[2] (000)		5 449 361	5 751 392

[1] United States dollar/Pula – 0.0889 (2014: 0.1052)
[2] SDR/Pula – 0.0642 (2014: 0.0727)

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME
Year ended December 31, 2015

	Notes	2015 P'000	2014 P'000
INCOME			
Interest – Foreign exchange reserves	16	1 271 312	1 147 416
Dividends – Foreign exchange reserves	17	562 428	472 768
Interest – Government of Botswana bond		1 997	2 000
Net gains from fair value changes on disposal of securities	18	991 575	1 446 836
Net realised currency gains	19	3 099 736	3 711 730
Net unrealised currency gains	20	3 868 432	–
Profit on foreign exchange deals		38 109	31 380
Other income		73 428	13 475
		9 907 017	6 825 605
EXPENSES			
Interest expense	22	182 601	196 168
Administration costs		442 301	507 414
Depreciation expense	3	26 694	25 975
Net unrealised currency losses	20	-	2 024 881
Net unrealised losses from fair value changes	21	120 037	1 398
		771 633	2 755 836
NET INCOME		9 135 384	4 069 769
OTHER COMPREHENSIVE INCOME			
Items that may be reclassified subsequently to profit or loss			
Net unrealised currency gains on non-monetary "available-for-sale" financial instruments		2 249 189	192 732
Net unrealised gains/losses from fair value changes on "available-for-sale" financial instruments		(325 205)	1 749 190
		1 923 984	1 941 922
TOTAL COMPREHENSIVE INCOME		11 059 368	6 011 691

STATEMENT OF DISTRIBUTION
Year ended December 31, 2015

	Note	2015 P'000	2014 P'000
TOTAL COMPREHENSIVE INCOME		11 059 368	6 011 691
Net unrealised currency gains on non-monetary "available-for-sale" financial instruments		(2 249 189)	(192 732)
Net unrealised losses/(gains) from fair value changes on "available-for-sale" financial instruments		325 205	(1 749 190)
NET INCOME		9 135 384	4 069 769
TRANSFER TO CURRENCY REVALUATION RESERVE	23	(6 869 975)	(1 621 302)
NET INCOME TO GOVERNMENT		2 265 409	2 448 467
TRANSFER TO GOVERNMENT INVESTMENT ACCOUNT		(1 132 377)	(1 378 778)
DIVIDEND		(975 000)	(700 000)
RESIDUAL NET INCOME	11	(158 032)	(369 689)

STATEMENT OF CASH FLOWS
Year ended December 31, 2015

	Notes	2015 P'000	2014 P'000
OPERATING ACTIVITIES			
Cash generated from operations	26	5 805 846	1 690 789
INVESTING ACTIVITIES			
Net withdrawals from/(investments into) foreign exchange reserves		3 123 371	(7 756 804)
Interest received from Government of Botswana bonds		1 997	2 000
Proceeds from disposal of property and equipment		1 234	847
Purchase of property and equipment	3	(18 489)	(28 487)
NET CASH GENERATED FROM/(USED IN) INVESTING ACTIVITIES		3 108 113	(7 782 444)
FINANCING ACTIVITIES			
Dividend to Government	11	(1 275 939)	(1 305 655)
Government (withdrawals)/investments		(7 747 246)	7 180 217
NET CASH (USED IN)/GENERATED FROM FINANCING ACTIVITIES		(9 023 185)	5 874 562
NET INCREASE IN CURRENCY IN CIRCULATION		(109 226)	(217 093)
CURRENCY IN CIRCULATION AT BEGINNING OF THE YEAR		(2 598 609)	(2 381 516)
CURRENCY IN CIRCULATION AT YEAR END		(2 707 835)	(2 598 609)

STATEMENT OF CHANGES IN SHAREHOLDER'S FUNDS

Year ended December 31, 2015

	Paid-up Capital P'000	Currency Revaluation Reserve P'000	Market Revaluation Reserve P'000	General Reserve P'000
BALANCE AT JANUARY 1, 2014	25 000	18 750 076	4 868 880	1 600 000
Total profit and other comprehensive income	–	192 732	1 749 190	–
Net unrealised currency gains on non-monetary "available for sale" financial instruments	–	192 732	–	–
Net unrealised gains from fair value changes on "available for sale" financial instruments	–	–	1 749 190	–
Net income	–	–	–	–
Transfers (to)/from Government Investment Account:	–	(836 100)	(1 401 791)	–
Net unrealised gains from fair value changes	–	–	(1 401 791)	–
Net unrealised currency gains	–	(836 100)	–	–
Excess of Government's share of net income from Pula Fund over dividend	–	–	–	–
Government Withdrawals	–	–	–	–
Transfer to Currency Revaluation Reserve	–	1 621 302	–	–
Dividend to Government	–	–	–	–
Residual net income	–	–	–	–
BALANCE AT DECEMBER 31, 2014	25 000	19 728 010	5 216 279	1 600 000
Total profit and other comprehensive income	–	2 249 189	(325 205)	–
Net unrealised currency gains on non-monetary "available for sale" financial instruments	–	2 249 189	–	–
Net unrealised losses from fair value changes on "available for sale" financial instruments	–	–	(325 205)	–
Net income	–	–	–	–
Transfers (to)/from Government Investment Account:	–	(4 935 420)	76 231	–
Net unrealised losses from fair value changes	–	–	76 231	–
Net unrealised currency gains	–	(4 935 420)	–	–
Excess of Government's share of net income from Pula Fund over dividend	–	–	–	–
Government withdrawals	–	–	–	–
Transfer to Currency Revaluation Reserve	–	6 869 975	–	–
Dividend to Government	–	–	–	–
Residual net income	–	–	–	–
BALANCE AT DECEMBER 31, 2015	25 000	23 911 754	4 967 305	1 600 000

Government Investment Account P'000	Accumulated Profit P'000	Total P'000	
26 463 736	–	51 707 692	**BALANCE AT JANUARY 1, 2014**
–	4 069 769	6 011 691	Total profit and other comprehensive income
–	–	192 732	Net unrealised currency gains on non-monetary "available for sale" financial instruments
–	–	1 749 190	Net unrealised gains from fair value changes on "available for sale" financial instruments
–	4 069 769	4 069 769	Net income
10 796 886	(1 378 778)	7 180 217	Transfers (to)/from Government Investment Account:
1 401 791	–	–	Net unrealised gains from fair value changes
836 100	–	–	Net unrealised currency gains
1 378 778	(1 378 778)	–	Excess of Government's share of net income from Pula Fund over dividend
7 180 217	–	7 180 217	Government Withdrawals
–	(1 621 302)	–	Transfer to Currency Revaluation Reserve
–	(700 000)	(700 000)	Dividend to Government
–	(369 689)	(369 689)	Residual net income
37 260 622	–	63 829 911	**BALANCE AT DECEMBER 31, 2014**
–	9 135 384	11 059 368	Total profit and other comprehensive income
–	–	2 249 189	Net unrealised currency gains on non-monetary "available for sale" financial instruments
–	–	(325 205)	Net unrealised losses from fair value changes on "available for sale" financial instruments
–	9 135 384	9 135 384	Net income
(1 755 680)	(1 132 377)	(7 747 246)	Transfers (to)/from Government Investment Account:
(76 231)	–	–	Net unrealised losses from fair value changes
4 935 420	–	–	Net unrealised currency gains
1 132 377	(1 132 377)	–	Excess of Government's share of net income from Pula Fund over dividend
(7 747 246)	–	(7 747 246)	Government withdrawals
–	(6 869 975)	–	Transfer to Currency Revaluation Reserve
–	(975 000)	(975 000)	Dividend to Government
–	(158 032)	(158 032)	Residual net income
35 504 942	–	66 009 001	**BALANCE AT DECEMBER 31, 2015**

SIGNIFICANT ACCOUNTING POLICIES
For the year ended December 31, 2015

REPORTING ENTITY

The Bank of Botswana (the Bank) is the central bank of Botswana established under the Bank of Botswana Act (CAP 55:01). The address of the Bank's registered office is 17938 Khama Crescent, Gaborone. These financial statements apply to the financial year ended December 31, 2015. The Government is the Bank's sole shareholder.

BASIS OF PRESENTATION OF FINANCIAL STATEMENTS

Statement of Compliance

The principal accounting policies applied in the preparation of the financial statements are stated below. These policies have been consistently applied to all the years presented and comply with International Financial Reporting Standards in all material respects.

The Financial Statements were authorised for issue by the Board on March 24, 2016.

Basis of Measurement

The financial statements are prepared on a historical cost basis, modified by fair value accounting for available-for-sale financial assets, all derivative contracts, financial assets and liabilities that are held at fair value through profit or loss.

Functional and Presentation Currency

The financial statements are presented in Pula, which is the Bank's functional currency. Except as otherwise indicated, financial information presented in Pula has been rounded to the nearest thousand.

STANDARDS AND INTERPRETATIONS IN ISSUE NOT YET ADOPTED

As at the date of finalisation of the financial statements, the following standards, relevant to the Bank's operations, are in issue and have not yet been adopted in the financial statements.

Standard	Effective for annual periods beginning on or after
Amendment to IAS 16 and IAS 38- Clarification of Acceptable Methods of Depreciation and Amortisation The clarification states that the revenue-based methods of depreciation are not acceptable, as these methods reflect generation of economic benefits by the asset, and not consumption of the asset. The amendments to IAS 38; Intangible Assets introduces rebuttable presumption that the use of revenue-based amortisation methods for intangible assets is inappropriate. The presumption can be overcome only when revenue and the consumption of the economic benefits of the intangible assets are "highly correlated" or when the intangible asset is expressed as a measure of revenue. The Bank uses the straight line method of depreciation, and not the revenue-based method, hence the amendments will have no impact on the Bank's financial statements.	January 1, 2016
Amendments to IAS 1 - Disclosure Initiative The amendments clarify that information should not be obscured by aggregating or providing immaterial information: materiality considerations must apply to all parts of the financial statements; and that even when a standard requires a specific disclosure, materiality considerations must apply. Adoption of the amendments is not expected to have any impact on the financial statements of the Bank.	January 1, 2016

SIGNIFICANT ACCOUNTING POLICIES (Continued)
For the year ended December 31, 2015

STANDARDS AND INTERPRETATIONS IN ISSUE NOT YET ADOPTED (Continued)

Standard	Effective for annual periods beginning on or after
IFRS 15 – Revenue from Contracts with Customers The standard replaces IAS 18 Revenue and other revenue standards. It contains a single model that applies to contracts with customers and two approaches to recognising revenue at a point in time or over time. The model features a contract-based five step analysis of transactions to determine whether, how much and when revenue is recognised. The Bank is currently in the process of performing a more detailed assessment of the impact of this standard on its financial statements.	January 1, 2018
IFRS 9 - Financial Instruments (Replacement of IAS 39) IFRS 9 published in July 2014 replaces IAS 39 Financial Instruments: Recognition and Measurement. Financial assets and liabilities are to be classified and measured based on the entity's business model on which they are held, and the characteristics of their contractual cash flows. IFRS 9 includes revised guidelines on the classification and measurement of financial instruments, including a new expected credit loss model for calculating impairment on financial assets and the new hedge accounting requirements. The Bank is assessing the full potential impact on its financial statements that will result from the adoption of IFRS 9. Early adoption is permitted, but the Bank will adopt it by the year ending December 31, 2018.	January 1, 2018
IFRS 16 - Leases (Replacement of IAS 17) IFRS 16 supersedes IAS 17 Leases, and it sets out principles for recognition, measurement, presentation and disclosure of leases. It provides a single lessee accounting model requiring lessees to recognise assets and liabilities for all leases unless the lease term is twelve months or less; or the underlying asset has a low value. Lessors will continue to classify leases as operating or finance leases. The Bank will perform a more detailed assessment of the impact of the adoption of the standard on its financial statements. Early adoption is permitted, but the Bank will adopt it effective January 1, 2019.	January 1, 2019

FINANCIAL INSTRUMENTS

General
Financial instruments carried on the Statement of Financial Position include all assets and liabilities, including derivative instruments, but exclude property and equipment and other assets (prepayments, VAT receivables, sundry receivables and sundry receipts).

Fair Value Measurement
"Fair value" is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or the most advantageous market to which the Bank has access at that date. The fair value of a liability reflects its non-performance risk.

SIGNIFICANT ACCOUNTING POLICIES (Continued)
For the year ended December 31, 2015

FINANCIAL INSTRUMENTS (Continued)

The Bank measures the fair value of a financial instrument using the quoted price in an active market for that particular instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

When quoted prices in an active market are not available, the Bank uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing a transaction.

Financial Assets
Financial assets are initially measured at fair value plus, in the case of financial assets not at fair value through profit or loss, incremental direct transaction costs and subsequently accounted for depending on their classification as either loans and receivables, held to maturity, fair value through profit and loss or available-for-sale.

Loans and Receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. These arise when the Bank provides a service directly to a counterparty. Loans and receivables (as well as prepayments, advances to banks and staff advances) are initially measured at fair value plus incremental direct transaction costs, and subsequently measured at amortised cost using the effective interest method less any identified impairment losses at the end of each reporting period.

Financial Assets at Fair Value through Profit or Loss
Financial assets are classified as fair value through profit or loss when the financial asset is held for trading. The Bank holds short-term investments as held for trading.

A financial asset is classified as held for trading if it is acquired principally for the purpose of selling it in the short-term or if so designated by management. Financial assets at fair value through profit or loss are stated at fair value, with any realised and unrealised gains and losses arising from changes in the fair value of financial assets recognised in profit or loss in the year in which they arise.

Short-term Investments (Liquidity Portfolio)
The Bank has designated the Liquidity Portfolio as a fund in which money market instruments and bonds are invested to facilitate payments for regular transactions.

Securities invested in this portfolio are measured "at fair value through profit or loss" and are classified as held for trading. They are initially recognised at fair value and are subsequently remeasured at fair value based on bid prices. All related realised and unrealised gains and losses are recognised in profit or loss.

All purchases and sales of investment securities in the portfolio are recognised at trade date, which is the date the Bank commits to purchase or sell the investments.

The realised and unrealised gains and losses recognised in profit or loss exclude interest and dividend income. Derivatives are classified as held for trading.

Available-For-Sale
Available-for-sale assets are non-derivative financial assets that are designated as available-for-sale or are not classified as another category of financial instruments. Available-for-sale instruments are intended to be held for long periods of time but may be sold in the normal course of business of the Bank.

Long-term Investments (Pula Fund)
This is a long-term fund intended to maximise returns and is invested in foreign financial instruments. These investments, which may be sold in response to needs for liquidity, changes in interest rates, exchange rates, etc., are classified as "available-for-sale", except for derivatives. These securities are initially recognised at fair value (which includes transaction costs) and are subsequently remeasured at fair value, based on bid prices.

All realised currency gains/losses are recognised in profit or loss. Unrealised currency gains/losses on monetary items are also recognised in profit or loss. The unrealised currency gains/losses on non-monetary items are recognised in other comprehensive income. However, in line with the Bank policy, all currency gains/losses for this Fund are not distributable and are, therefore, appropriated to the Currency Revaluation Reserve.

SIGNIFICANT ACCOUNTING POLICIES (Continued)
For the year ended December 31, 2015

FINANCIAL INSTRUMENTS (Continued)

Realised fair value changes are recognised in profit or loss. Unrealised fair value changes are recognised in other comprehensive income. Unrealised gains and losses arising from fair value changes of the instruments classified as "available-for-sale" are non-distributable as per the Bank's policy and are appropriated to the Market Revaluation Reserve. When these instruments are disposed of or impaired, the related accumulated fair value or impairment adjustments are included in profit or loss as gains or losses from investment securities.

All purchases and sales of investment securities in the portfolio are recognised at trade date, which is the date the Bank commits to purchase or sell the investments.

Government of Botswana Bonds

The Bank acquires Government of Botswana bonds for purposes of facilitating orderly trading in the local bond market. The bonds, which may be sold in response to the need to intervene in the market, are classified as "available-for-sale" securities.

The bonds are initially recognised at fair value and are subsequently remeasured at fair value, based on bid prices. All unrealised gains and losses arising from changes in the fair value are recognised in the Market Revaluation Reserve. When these instruments are disposed of or impaired, the related accumulated fair value adjustments are included in profit or loss as gains or losses from Government of Botswana bonds.

All purchases and sales of bonds are recognised at trade date, which is the date that the Bank commits itself to purchase or sell the bonds.

Derivative Instruments
The Bank uses a variety of derivative instruments to manage its exposure to interest rate and foreign exchange risks, including interest rate futures, foreign exchange forward contracts, cross-currency swaps and options.

Derivative instruments are initially recognised at fair value (including transaction costs) and are subsequently remeasured at fair value, based on bid prices for assets held or liabilities to be issued, and ask/offer prices for assets to be acquired or liabilities held. The resulting gain or loss is recognised in the profit or loss.

Impairment of Financial Assets
Financial assets other than loans and receivables are carried at fair value. "Loans and receivables" are assessed for any evidence of impairment at each Statement of Financial Position date. Financial assets are impaired when there is objective evidence that as a result of one or more events that have occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been adversely impacted. For financial assets carried at amortised cost, the amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. In respect of "available-for-sale" equity securities, any increase in fair value subsequent to an impairment loss is recognised directly in other comprehensive income.

Financial Liabilities
All the Bank's financial liabilities are classified as other financial liabilities at amortised cost. Financial liabilities are initially recognised at fair value and subsequently measured at amortised cost using the effective interest method.

Derecognition
The Bank derecognises a financial asset when it loses control over the contractual rights that comprise the asset and transfers substantially all the risks and benefits associated with the asset. This arises when the rights are realised, expire or are surrendered. A financial liability is derecognised when its contractual obligations are discharged, cancelled or expire.

Other Financial Liabilities
Other financial liabilities are initially measured at fair value, net of transaction costs.

Other financial liabilities are subsequently measured at amortised cost using the effective interest method, with interest expense recognised on the effective yield basis. The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts future cash payments through the expected life of the financial liability, or where appropriate, a shorter period.

Bank of Botswana Certificates
As one of the primary tools for maintaining monetary stability in the economy, the Bank of Botswana issues its own paper, Bank of Botswana Certificates (BoBCs), to absorb excess liquidity in the market and thereby influence short term interest rates. BoBCs are issued at a discount to counterparties. They are classified as "other financial liabilities".

SIGNIFICANT ACCOUNTING POLICIES (Continued)
For the year ended December 31, 2015

FINANCIAL INSTRUMENTS (Continued)

The Bank's liability in respect of BoBCs is stated at offer prices on auction date, adjusted for movements in matured and unmatured discount recognised in profit or loss.

CREDIT FACILITY

Under the Credit Facility, the Bank provides emergency and intermittent funding to solvent banks, intended to bridge intra-day and overnight liquidity shortages. The advances are secured by Government of Botswana bonds and Bank of Botswana Certificates (BoBCs), valued at fair value prices on the date of the transaction. Only high quality, marketable and freely transferable paper with a minimum amount of risk is acceptable as collateral at the discretion of the Bank. Government bonds and Government guaranteed securities of any maturity and other eligible paper with a remaining maturity of 184 days or less are also acceptable as security. The Bank has the right to call for additional collateral, should the value of the security decline during the tenure of the facility. Interest earned on the advances is credited to profit or loss, while advances outstanding as at the Statement of Financial Position date are recorded under "other assets".

SECURITIES LENDING PROGRAMME

The Bank takes part in a Securities Lending Programme. Where securities are lent, the Bank holds collateral in the form of cash or other securities. The securities lent continue to be recorded in the Bank's Statement of Financial Position.

The Bank's global custodian administers the Securities Lending Programme and monitors the securities lent and related collateral against requirements agreed by the Bank.

The Bank records income from lending securities as it accrues.

REPURCHASE AND REVERSE REPURCHASE AGREEMENTS

This facility is one of the mechanisms designed to deal with short-term liquidity fluctuations in the domestic money market. It is available to primary counterparties which are solvent institutions licensed and supervised by the Bank.

The term of a repurchase agreement and reverse repurchase agreement can vary from overnight to 91 days, depending on the liquidity conditions in the domestic market.

Interest earned by the Bank on repurchase agreements and interest paid by the Bank on reverse repurchase agreements is recognised in profit or loss.

OFFSETTING FINANCIAL INSTRUMENTS

The Bank offsets financial assets and liabilities and reports the net balance in the Statement of Financial Position where:

(a) There is a legally enforceable right to set off; and
(b) There is an intention to settle on a net basis or to realise the asset and settle the liability simultaneously.

FOREIGN CURRENCIES

All transactions denominated in foreign currencies are translated to Pula at the mid exchange rate at the transaction date. All assets and liabilities denominated in foreign currencies are translated to Pula using mid rates of exchange at the close of the financial year. Foreign currency differences arising on translation are recognised in profit or loss, except for unrealised exchange differences arising on translation of non-monetary "available-for-sale" financial instruments, which are recognised in other comprehensive income. However, all gains and losses relating to disposals whose proceeds are reinvested in foreign assets, and all the unrealised gains/losses arising on financial instruments are not considered distributable in terms of Bank policy; they are appropriated to the Currency Revaluation Reserve.

NON-FINANCIAL ASSETS, LIABILITIES AND RECOGNITION OF PROVISIONS

Non-financial Assets
Non-financial assets are recognised when the Bank obtains control of a resource as a result of past events, and from which future economic benefits are expected to flow to the Bank.

SIGNIFICANT ACCOUNTING POLICIES (Continued)
For the year ended December 31, 2015

FINANCIAL INSTRUMENTS (Continued)

Contingent Assets

The Bank discloses a contingent asset arising from past events where it is probable that economic benefits will flow from it, but this will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events outside the control of the Bank.

Liabilities and Provisions

The Bank recognises liabilities (including provisions) when:

(a) It has a present legal obligation resulting from past events;
(b) It is probable that an outflow of resources embodying economic benefits will be required to settle this obligation; and
(c) A reliable estimate of the amount of the obligation can be made.

INCOME AND EXPENSE RECOGNITION

Interest income on all assets is calculated using the effective interest method and is recognised in profit or loss. The 'effective interest rate' is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or financial liability to the carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Bank estimates future cash flows considering all contractual terms of the financial instrument, but not future credit losses. The calculation of the effective interest rate includes transaction costs that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or financial liability.

Interest income and expense presented in the statement of profit or loss and other comprehensive income include:

(a) interest on financial assets and financial liabilities measured at amortised cost calculated on an effective interest basis; and
(b) interest on available-for-sale investment securities calculated on an effective interest rate basis.

Dividends on available-for-sale equity instruments are recognised in profit or loss when the right to receive payment is established. Usually, this is the ex-dividend date for quoted equities.

GENERAL RESERVE

Under Section 7(1) of the Bank of Botswana Act, (CAP 55:01), the Bank of Botswana is required to establish and maintain a General Reserve sufficient to ensure the sustainability of future operations of the Bank. The Bank may transfer to the General Reserve funds from other reserves, which it maintains, for the purposes of maintaining the required level of the General Reserve.

CURRENCY REVALUATION RESERVE

Any changes in the valuation, in terms of Pula, of the Bank's assets and liabilities in holdings of Special Drawing Rights and foreign currencies as a result of any change in the values of exchange rates of Special Drawing Rights or foreign currencies and in realised currency gains reinvested in foreign assets are transferred to the Currency Revaluation Reserve.

The proportion directly attributable to the Government Investment Account is transferred to such investment account.

MARKET REVALUATION RESERVE

Any changes in the value of the Bank's long-term investments as a result of any change in the fair values of such investments are transferred to the Market Revaluation Reserve.

The proportion directly attributable to the Government Investment Account is transferred to such investment account.

GOVERNMENT INVESTMENT ACCOUNT

The Government Investment Account, which was established on January 1, 1997, represents the Government's share of foreign exchange reserves in the Pula Fund and Liquidity Portfolio.

SIGNIFICANT ACCOUNTING POLICIES (Continued)
For the year ended December 31, 2015

PROPERTY AND EQUIPMENT

Property and equipment are stated at cost less related accumulated depreciation and any accumulated impairment losses.

Land and buildings are carried at cost. These are valued on a fair value basis every two years, and the recoverable (revalued) amounts disclosed by way of a note to the Financial Statements, providing that revalued amounts are in excess of the carrying amounts. Where the carrying amounts are more than the revalued amounts, an impairment loss is recognised in profit or loss.

At each Statement of Financial Position date, the Bank reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any).

Any impairment loss is recognised immediately in profit or loss.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years.

If significant parts of an item of property or equipment have different useful lives, they are accounted for as separate items (major components) of property and equipment.

Depreciation
Depreciation is charged so as to write-off the cost of assets less residual values, other than land and buildings under construction, over their estimated useful lives, using the straight-line method. The estimated useful lives, residual values and depreciation methods are reviewed at each year end, with the effect of any changes in the estimate accounted for on a prospective basis.

The annual depreciation rates used in the calculation of depreciation are as follows:

	Percent
Buildings	2.5 – 6
Other Assets	
Furniture, fixtures and equipment	5 – 25
Computer hardware	25
Computer software	20
Motor vehicles	5 - 25

A gain or loss arising on disposal or retirement of an item of property and equipment is determined as the difference between the net sales proceeds and the carrying amount of the asset and is recognised in profit or loss.

Capital works in progress comprise costs directly attributable to the construction of an asset. Assets remain in capital works in progress until they have become available for use or commissioned, whichever is the earlier date. At that time, these assets are transferred to the appropriate class of property and equipment as additions and depreciated.

Subsequent expenditure is capitalised only when it is probable that the future economic benefits of the expenditure will flow to the Bank. Ongoing repairs and maintenance are expensed as incurred.

RETIREMENT BENEFITS

Pension benefits are provided for employees through the Bank of Botswana Defined Contribution Staff Pension Fund, which is governed in terms of the Pension and Provident Funds Act (CAP 27:03). The contribution per pensionable employee is at the rate of 21.5 percent of pensionable salary, which comprises 16 percent and 1.5 percent payable by the Bank as its contribution to the Fund and for administration costs of the Fund, respectively, and a 4 percent contribution by each pensionable employee. Other than the contributions made, the Bank has no commitments or obligations to this Fund. Obligations for contributions to the pension fund are recognised in profit or loss in the periods during which services are rendered by employees.

SHORT-TERM EMPLOYEE BENEFITS

Short-term employee benefits obligations are measured on an undiscounted basis and are expensed as the related service is provided.

SIGNIFICANT ACCOUNTING POLICIES (Continued)
For the year ended December 31, 2015

FINANCE LEASES

Assets held by the Bank under leases that transfer to the Bank substantially all of the risks and rewards of ownership are classified as finance leases. The leased asset is initially measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

Assets held under other leases are classified as operating leases and are not recognised in the Bank's statement of financial position.

RELATED PARTY TRANSACTIONS

The Bank enters into various transactions with other wholly owned or partly owned Government institutions and its key management personnel (related parties). All related party transactions are entered into at arm's length in the ordinary course of business. The transactions with key management personnel are staff benefits provided under the General Conditions of Service of the Bank.

SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

The Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Useful Lives of Property and Equipment
Management reviews the estimated useful lives of property and equipment at the end of each annual reporting period. In this financial year, no change was made to the useful lives, hence the depreciation rates provided are similar with the prior year.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS
December 31, 2015

	2015 P'000	2014 P'000
1. FOREIGN EXCHANGE RESERVES		
1.1 Liquidity Portfolio		
Bonds: held for trading	12 904 792	9 559 860
Amounts due from Pula Fund	1 071 669	784 979
Short-term deposits	7 937 959	12 379 062
	21 914 420	22 723 901
1.2 Pula Fund		
Equities: available-for-sale	28 253 210	23 817 720
Bonds: available-for-sale	33 418 814	30 382 537
Derivative instruments: assets (Note 13)	30 233	8 273
Amounts due to Liquidity Portfolio	(1 071 669)	(784 979)
Derivative instruments: liabilities (Note 13)	(21 770)	(8 512)
Short-term deposits	574 632	1 342 485
	61 183 450	54 757 524
(a) Statement of Financial Position		
Capital Employed		
Government	35 004 942	37 260 596
Bank of Botswana	26 178 508	17 496 928
	61 183 450	54 757 524
Employment of Capital		
Investments	61 183 450	54 757 524
Investments expressed in US dollars ('000)[3]	5 439 208	5 760 491
Investments expressed in SDR ('000)[4]	3 927 978	3 980 872
(b) Statement of Profit or Loss and Other Comprehensive Income		
Income		
Interest and dividends	1 279 454	1 198 863
Realised currency revaluation gains	1 610 182	2 289 736
Unrealised currency revaluation gains/(losses)	2 822 091	(1 237 900)
Realised gains from fair value changes	1 045 107	1 526 359
Sundry income	1 440	1 062
	6 758 274	3 778 120
Expenses		
Administration charges	166 539	165 138
	166 539	165 138
Net income	6 591 735	3 612 982
Other Comprehensive Income		
Items that may be reclassified subsequently to profit or loss		
Net unrealised currency gains on non-monetary "available-for-sale" financial instruments	2 249 189	192 732
Net unrealised (losses)/gains from fair value changes on "available-for-sale" financial instruments	(324 805)	1 749 995
Other comprehensive income	1 924 384	1 942 727
Total comprehensive income	8 516 119	5 555 709

[3] United States dollar/Pula – 0.0889 (2014: 0.1052)
[4] SDR/Pula – 0.0642 (2014: 0.0727)

The increase in excess liquidity resulted from the reduction of the primary reserve requirement (intended to address tight liquidity

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
December 31, 2015

	2015 P'000	2014 P'000

2. INTERNATIONAL MONETARY FUND (IMF)

2.1 Reserve Tranche

This asset represents the difference between Botswana's Quota in the IMF and IMF Holdings of Pula. Botswana's Quota is the membership subscription, of which at least 25 percent was paid for in foreign currencies and the balance in Pula. The holding of Pula by the IMF, which initially was equal to 75 percent of the quota, has changed from time to time as a result of the use of the Pula by the IMF in lending to member countries.

	2015 P'000	2014 P'000
Quota (SDR 87 800 000; 2014: SDR 87 800 000)	1 366 579	1 207 255
Less: IMF Holdings of Pula	(942 040)	(777 211)
Reserve Position in IMF	424 539	430 044

The IMF Holdings of Pula are represented by the Non-Interest Bearing Note of P353 179 294 (2014: P353 179 294) issued by the Government of Botswana in favour of the IMF, maintenance of value currency adjustments and the amount in the current account held at the Bank (included in other deposits in Note 10).

2.2 Holdings of Special Drawing Rights

	2015 P'000	2014 P'000
The balance on the account represents the value of Special Drawing Rights (SDR) allocated and purchased less utilisation to date.	1 334 931	1 178 929

2.3 General Subsidy Account

	2015 P'000	2014 P'000
Face Value (SDR 1 520 000)	23 658	20 900
Interest	8	7
	23 666	20 907

This is an investment with the International Monetary Fund, the purpose of which is to augment the resources of the Poverty Reduction and Growth Trust Fund. The investment is expected to generate SDR 0.2 million over five years. It matures on August 22, 2017.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
December 31, 2015

3. PROPERTY AND EQUIPMENT	Freehold Land	Leasehold Land	Buildings	Capital Works in Progress	Other Assets	Total
	P'000	P'000	P'000	P'000	P'000	P'000
Cost – December 31, 2015						
Balance at the beginning of the year	2 065	3 083	399 931	6 117	183 612	594 808
Additions	–	–	–	6 357	12 132	18 489
Disposals	–	–	–	–	(3 735)	(3 735)
Transfers from WIP	–	–	497	(1 412)	915	–
Balance at year–end	2 065	3 083	400 428	11 062	192 924	609 562
Accumulated Depreciation						
Balance at the beginning of the year	–	–	75 231	–	105 959	181 190
Charge for the year	–	–	10 587	–	16 107	26 694
Disposals	–	–	–	–	(2 092)	(2 092)
Balance at year–end	–	–	85 818	–	119 974	205 792
Net book value at December 31, 2015	2 065	3 083	314 610	11 062	72 950	403 770
Cost – December 31, 2014						
Balance at the beginning of the year	2 065	3 083	385 709	3 357	176 042	570 256
Additions	–	–	–	17 051	11 436	28 487
Disposals	–	–	–	–	(3 935)	(3 935)
Transfers from WIP	–	–	14 222	(14 291)	69	–
Balance at year–end	2 065	3 083	399 931	6 117	183 612	594 808
Accumulated Depreciation						
Balance at the beginning of the year	–	–	65 074	–	93 093	158 167
Charge for the year	–	–	10 157	–	15 818	25 975
Disposals	–	–	–	–	(2 952)	(2 952)
Balance at year–end	–	–	75 231	–	105 959	181 190
Net book value at December 31, 2014	2 065	3 083	324 700	6 117	77 653	413 618

Valuation of Properties

Freehold and leasehold land and buildings were valued by an independent professional property valuer in December 2014 at an open market value of P770 940 000 (2012: P353 699 000).

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
December 31, 2015

	2015 P'000	2014 P'000
4. GOVERNMENT OF BOTSWANA BOND		
Government Bond BW005, maturing on September 12, 2018, bearing interest at the rate of 10 percent, receivable semi-annually in arrears:		
Fair value	23 123	23 524
Interest accrued	610	613
	23 733	24 137
5. OTHER ASSETS		
Staff loans and advances	52 579	49 663
Prepayments	3 677	2 868
Other	66 348	88 290
	122 604	140 821
6. ALLOCATION OF IMF SPECIAL DRAWING RIGHTS		
This is the liability of the Bank to the IMF in respect of the allocation of SDRs to Botswana.	893 912	789 694
7. LIABILITIES TO GOVERNMENT (IMF RESERVE TRANCHE)		
This balance represents the Bank's liability to the Government in respect of the Reserve Tranche position in the IMF (Note 2.1).	358 931	364 435
8. NOTES AND COIN IN CIRCULATION		
Notes	2 564 979	2 466 520
Coin	142 856	132 089
	2 707 835	2 598 609

Notes and coin in circulation held by the Bank as cash in hand at the end of the financial year have been netted off against the liability for notes and coin in circulation to reflect the net liability to the public.

	2015 P'000	2014 P'000
9. BANK OF BOTSWANA CERTIFICATES		
Face value	8 192 650	4 208 000
Unmatured discount	(2 728)	(6 616)
Carrying amount	8 189 922	4 201 384

Bank of Botswana Certificates are issued at various short-term maturity dates and discount rates.

	2015 P'000	2014 P'000
9.1 REVERSE REPURCHASE AGREEMENTS		
Fair value	1 672 849	304 357

The reverse repurchase agreements matured on January 4, 2016 (2014: January 5, 2015).

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
December 31, 2015

10. DEPOSITS

	2015 P'000	2014 P'000
Government	888 240	781 246
Bankers - current accounts	429 700	38 340
- statutory reserve accounts	2 588 660	4 420 809
Other	1 160 772	1 601 433
	5 067 372	6 841 828

These deposits are various current accounts of Government, commercial banks, parastatal bodies and others, which are repayable on demand and are interest free, except for the statutory reserve requirement, which is also interest free, but not repayable on demand.

11. DIVIDEND TO GOVERNMENT

	2015 P'000	2014 P'000
Balance due at the beginning of the year	544 689	780 655
Dividend to Government from Pula Fund	975 000	700 000
Paid during the year	(1 275 939)	(1 305 655)
Residual net income	158 032	369 689
Balance due at the end of the year	401 782	544 689

The final instalment of the pre-set dividend of P243 750 000 and the residual net income of P158 032 000 unpaid as at December 31, 2015 was provided for in accordance with Section 6 of the Bank of Botswana Act (CAP 55:01); which requires that all profits of the Bank be distributed to the shareholder, the Government.

12. OTHER LIABILITIES

	2015 P'000	2014 P'000
Accounts payable	10 713	9 326
Other payables and accruals	118 796	205 648
	129 509	214 974

13. CATEGORIES OF FINANCIAL INSTRUMENTS

13.1 Financial Assets

	2015 P'000	2014 P'000
Held for trading		
Bonds	12 904 792	9 559 860
Derivative instruments (Note 1.2)	30 233	8 273
	12 935 025	9 568 133
Available-for-sale		
Bonds	33 418 814	30 382 537
Equities	28 253 210	23 817 720
Government bonds	23 733	24 137
	61 695 757	54 224 394
Loans and Receivables		
IMF Reserves	1 783 136	1 629 880
Staff loans and advances	52 579	49 663
Short-term deposits	8 512 591	13 721 547
Total Financial Assets	84 979 088	79 193 617

The above is disclosed in the Statement of Financial Position as follows:

	2015 P'000	2014 P'000
Total Foreign Assets	84 881 006	79 111 305
Add: Derivative instruments (liabilities)	21 770	8 512
Government of Botswana bonds	23 733	24 137
Other Assets - staff loans and advances (Note 5)	52 579	49 663
	84 979 088	79 193 617

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
December 31, 2015

	2015 P'000	2014 P'000
13. **CATEGORIES OF FINANCIAL INSTRUMENTS (Continued)**		
13.2 **Financial Liabilities**		
Held for trading		
Derivative instruments (Note 1.2)	21 770	8 512
Other Financial Liabilities - at amortised cost		
Bank of Botswana Certificates	8 189 922	4 201 384
Reverse Repurchase Agreements	1 672 849	304 357
Allocation of SDR (IMF)	893 912	789 694
Liabilities to Government (IMF)	358 931	364 435
Deposits	5 067 372	6 841 828
Dividend to Government	401 782	544 689
Other liabilities	129 509	214 974
	16 736 047	13 269 873

13.3 **Derivative Instruments**

The Bank's investment guidelines authorise the use of derivative instruments. The derivatives are held for managing risk.

The Table below shows the market values and the total notional exposures of derivative instruments as at year end.

		Asset 2015 (P'000)	Liabilities 2015 (P'000)	Notional Amount 2015 (P'000)	Assets 2014 (P'000)	Liabilities 2014 (P'000)	Notional Amount 2014 (P'000)
Fixed Income Futures	–Buy	30 233	–	651 841	8 365	–	426 293
	–Sell	–	(21 770)	(662 833)	–	(8 512)	(420 121)
Currency Futures	–Buy	–	–	–	(92)	–	119
		30 233	(21 770)	(10 992)	8 273	(8 512)	6 291

The above derivatives are classified by type of asset and derivative instruments. The assets and liabilities reflect the net position between the market values and the notional amounts.

Futures
A futures contract is an agreement executed on the floor of an exchange to buy or sell a specific amount of a security or cash at a specified price and time. A fixed income futures contract would be an agreement to either buy or sell a specified amount of a fixed income security at a specified price and date, while a currency futures contract will be an agreement to either buy or sell a specified amount of currency at a specified exchange rate and date. Futures contracts are collateralised by cash or marketable securities and changes in the futures contract values are settled daily.

Options
An option is an exclusive right, usually obtained for a fee, but not the obligation to buy or sell a specific financial instrument within a specified time. A fixed income option is the exclusive right to either buy or sell specified units of a fixed income security by a specific date. A currency option is an option to either buy or sell a specified currency by a specific date.

Swaps
A swap is an agreement between two or more parties to exchange sets of cash flows over a period in the future, typically either in the form of interest rate swaps or currency swaps. The cash flows that the counterparties make are linked to the value of the underlying debt financial instrument or the foreign currency, as the case may be.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
December 31, 2015

	2015 P'000	2014 P'000
14. PAID-UP CAPITAL		
Authorised and Paid-up Capital	25 000	25 000
The capital is the amount subscribed by the Government in accordance with Section 5 of the Bank of Botswana Act (CAP 55:01). The Bank is not subject to any externally imposed capital requirements. Therefore, capital is not actively managed. Management considers the Paid-up Capital and the General Reserve to be capital.		
15. GENERAL RESERVE		
In the opinion of the Board, the General Reserve, taken together with other reserves which the Bank maintains, is sufficient to ensure the sustainability of future operations of the Bank.	1 600 000	1 600 000
16. INTEREST – FOREIGN EXCHANGE RESERVES		
Liquidity Portfolio		
Short-term deposits: loans and receivables	321 815	219 799
Bonds: held for trading	230 647	199 780
IMF Reserves: loans and receivables	383	679
Pula Fund		
Short-term deposits: loans and receivables	20 235	17 390
Bonds: available-for-sale	698 232	709 768
	1 271 312	1 147 416
17. DIVIDENDS – FOREIGN EXCHANGE RESERVES		
Pula Fund		
Equities: available-for-sale	562 428	472 768
18. NET GAINS FROM FAIR VALUE CHANGES ON DISPOSAL OF SECURITIES		
Liquidity Portfolio		
Bond: held for trading	(53 532)	(79 523)
Pula Fund		
Derivative instrument: held for trading	7 373	38 752
Bonds: available-for-sale	273 788	509 613
Equities: available-for-sale	763 946	977 994
	991 575	1 446 836
Included above are net fair value gains of P1 037 734 000 (2014: P1 487 607 000), which have been reclassified from equity to profit or loss on disposal of investments classified as available-for-sale.		
19. NET REALISED CURRENCY GAINS		
Liquidity Portfolio		
Short-term deposits: loans and receivables	965 028	585 143
Bonds: held for trading	524 526	836 851
Pula Fund		
Derivative instruments: held for trading	8 276	(16 565)
Short-term deposits: loans and receivables	68 621	16 005
Bonds: available-for-sale	930 847	1 925 864
Equities: available-for-sale	602 438	364 432
	3 099 736	3 711 730

Included above are net currency gains of P1 533 285 000 (2014: P2 290 296 000) which have been reclassified from equity to profit or loss on disposal of investments classified as available-for-sale.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
December 31, 2015

	2015 P'000	2014 P'000
20. NET UNREALISED CURRENCY GAINS/(LOSSES)		
Liquidity Portfolio		
Short-term deposits: loans and receivables	101 284	(139 026)
Bonds: held for trading	890 898	(658 608)
IMF reserves: loans and receivables	54 159	10 654
Pula Fund		
Short-term deposits: loans and receivables	(9 070)	20 129
Bonds: available-for-sale	2 820 668	(1 259 726)
Derivative instruments: held for trading	10 493	1 696
	3 868 432	(2 024 881)
21. NET UNREALISED LOSSES FROM FAIR VALUE CHANGES		
Liquidity Portfolio		
Bonds: held for trading	(118 007)	537
Pula Fund		
Derivative instruments: held for trading	(2 030)	(1 935)
	(120 037)	(1 398)
22. INTEREST EXPENSE		
Bank of Botswana Certificates (BoBCs)	113 334	173 621
Reverse Repurchase Agreements	69 267	22 547
	182 601	196 168
23. NET CURRENCY REVALUATION GAINS RETAINED IN PROFIT OR LOSS		
Total net realised gains (Note 19)	3 099 736	3 711 730
Total net unrealised (gains)/losses (Note 20)	3 868 432	(2 024 881)
Total net currency revaluation gains	6 968 168	1 686 849
Appropriated to Currency Revaluation Reserve:		
Net realised currency gains and reinvested in foreign assets	(3 001 543)	(3 646 183)
Net unrealised currency (gains)/losses (Note 20)	(3 868 432)	2 024 881
Transfer to Currency Revaluation Reserve	(6 869 975)	(1 621 302)
Net currency revaluation gains retained in profit or loss	98 193	65 547

24. CONTRIBUTION TO THE BANK OF BOTSWANA DEFINED CONTRIBUTION STAFF PENSION FUND

The Bank's contribution to the Bank of Botswana Defined Contribution Staff Pension Fund for the year ended December 31, 2015 is P26 234 000 (2014: P24 121 000).

25. STATEMENT OF CASH FLOWS

The definition of cash in IAS 7 is not wholly appropriate to the Bank. Due to its role in the creation and withdrawal of currency in circulation, the Bank has no cash balances on its Statement of Financial Position (see Note 8). However, the Bank has the ability to create cash when needed.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
December 31, 2015

	2015 P'000	2014 P'000
26. CASH GENERATED FROM OPERATIONS		
Net income for the year adjusted for:	9 135 384	4 069 769
Net realised and unrealised exchange gains	(6 869 975)	(1 621 302)
Depreciation expense	26 694	25 975
Loss on disposal of Property and Equipment	414	135
Interest: Government of Botswana bonds	(1 997)	(2 000)
	2 290 520	2 472 577
Adjustments for movements in:		
Deposits: banks and other	(1 881 451)	58 120
Deposits: Government	106 994	(173 684)
Bank of Botswana Certificates	3 988 538	(1 289 340)
Reverse Repurchase Agreements	1 368 492	304 357
Repurchase Agreements	–	302 078
Other assets	18 218	(52 432)
Other liabilities	(85 465)	69 113
Cash generated from operations	5 805 846	1 690 789
27. CAPITAL COMMITMENTS		
Approved and contracted for	3 174	68 970
Approved, but not contracted for	57 898	12 165
	61 072	81 135

These capital commitments will be funded from internal resources.

28. COLLATERAL

(a) Credit Facility

There were no open positions as at December 31, 2015 (2014: Nil) under the Credit Facility accounted for as "Advances to banks".

(b) **Securities Lending Programme**

Under the Bank's Securities Lending Programme, the Bank has lent securities with a fair value of P9 billion (2014: P7.1 billion). The Bank has accepted securities with a fair value of P9.4 billion (2014: P7.4 billion) as collateral for the securities lent under this programme.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
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29. GOVERNMENT OF BOTSWANA BONDS AND TREASURY BILLS

In accordance with Sections 56 and 57 of the Bank of Botswana Act (CAP 55:01), the Bank acts as agent of the Government for the issuance and management of the Government Bonds and Treasury Bills. An analysis of the bonds and treasury bills issued during the financial year ended December 31, 2015 is provided below:

Government of Botswana Bonds and Treasury Bills issued during the year 2015

Bond/ Treasury Bill Detail	BW005	BW007	BW008	BW011	BW012	BW090915	BW091215	BW090316	BW080616	Total
Date of Issue	Jun 10/Dec 09, 2015	Sept/Dec 9, 2015	Sept/Dec 9, 2015	March 11/ June 10 Sept/Dec, 9 2015	June 10/ Sept Dec 9, 2015	March 11, 2015	June 10, 2015	Sept 9, 2015	Dec 9, 2015	
Date of Maturity	Sept 12, 2018	March 10, 2025	Sept 8, 2020	Sept 10, 2031	June 13, 2040	Sept 9, 2015	Dec 9, 2015	March 9, 2016	June 8, 2016	
Interest Rate Percent (per annum)	10	8	7.75	7.75	6	–	–	–	–	
	P'000	P'000	P'000	P'000	P'000	P'000	P'000	P'000	P'000	P'000
Nominal Value	105 000	115 000	150 000	500 000	437 000	339 000	340 000	500 000	340 000	2 826 000
Net (Discount)/ Premium	19 316	25 156	21 646	105 776	(11 202)	(4 831)	(4 192)	(4 325)	(2 689)	144 655
Net Proceeds	124 316	140 156	171 646	605 776	425 798	334 169	335 808	495 675	337 311	2 970 655
Interest Paid	250	600	–	9 687	10 110	4 831	4 192	–	–	29 670
Interest Accrued	3 202	2 856	3 673	12 029	1 361	–	–	2 709	340	26 170

(a) Net proceeds realised from the issue of the bonds of P2 970 655 000 (2014: P1 944 944 000) were invested in the Government Investment Account. The nominal value of holdings of total outstanding Government bonds and treasury bills as at December 31, 2015, was P7 196 000 000 (2014: P7 230 000 000).

(b) Interest is payable on all bonds on a semi-annual basis in arrears. During the year to December 31, 2015, total interest payments of P628 738 550 were made (2014: P577 715 950) and were funded from the Government's current account maintained with the Bank.

(c) Government bonds and treasury bills are liabilities of Government; and they are, therefore, not accounted for in the Statement of Financial Position of the Bank.

30. RISK MANAGEMENT IN RESPECT OF FINANCIAL INSTRUMENTS

Risk is inherent in the Bank's management of financial instruments which comprise primarily foreign assets, which are held in various financial instruments. This risk is managed through a process of ongoing identification, measurement and monitoring that is subject to an extensive framework of risk limits and other controls. The process of risk management is critical to the Bank's ongoing operations, with the day to day management of the financial instruments being conducted by the Financial Markets Department. A key element in the risk management of the foreign exchange reserves is safety, defined as the preservation of purchasing power of the foreign exchange reserves. To this end, the Bank has continued to pursue a conservative and diversified investment strategy, with an SDR weighted currency allocation as the benchmark. The Bank's objectives, policies and procedures for managing the risk exposures and the method used to measure the risks have remained consistent with the prior year. The risk management framework remains sound and effective.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
December 31, 2015

30. RISK MANAGEMENT IN RESPECT OF FINANCIAL INSTRUMENTS (Continued)

Risk Management Governance Structure
The Bank's risk management governance structure is broadly as follows:

(a) Board

The Board is responsible for the Bank's overall risk management and for approving investment policies and guidelines. The Bank's management reviews the risk management policies from time to time.

(b) Investment Committee

The Investment Committee, which is chaired by the Governor and comprises representatives from relevant areas of the Bank, meets regularly to review developments in the international financial and capital markets. Where necessary, the Investment Committee makes decisions on Bank managed portfolios. The Investment Committee also monitors the performance of the external fund managers.

(c) Financial Markets Department

The Financial Markets Department is responsible for the management of the foreign exchange reserves and has a specialised Risk Management Unit focusing on the risks associated with all the investment portfolios and ensures compliance with Investment Guidelines.

(d) Segregation of Duties

At an operational level, the main feature of risk control is the segregation of duties relating to dealing, settlement, risk monitoring and recording. These responsibilities are split among three Departments: Financial Markets, Payments and Settlement and Finance.

Tranching of Foreign Exchange Reserves – Liquidity Portfolio and Pula Fund
The Bank of Botswana Act (CAP 55:01) requires the Bank to maintain a primary international reserve, that is, the Liquidity Portfolio, while Section 35 provides for the establishment and maintenance of a long-term investment fund, the Pula Fund. In compliance with the statutory requirements, a major feature of the foreign exchange reserves management strategy is, therefore, to allocate a certain level of reserves to the Liquidity Portfolio, with the remaining amount invested in the Pula Fund.

Pula Fund
Investments of the Pula Fund comprise long-term assets, such as long-dated bonds and equities actively traded in liquid markets, with the expectation of earning a higher return than could be achieved on conventionally managed investments. The asset allocation between bonds and equities is determined using a combination of historical data and assumptions. Exercises are also conducted in respect of the Pula Fund risk/return sensitivity analysis, using different portfolio options, where risk is measured by a standard deviation on the rate of return.

Liquidity Portfolio
In terms of the investment guidelines, the Liquidity Portfolio gives priority to liquidity over return, given the constant need to provide foreign exchange to finance international transaction payments. While the eligible investment currencies are similar to those of the Pula Fund, the Liquidity Portfolio is largely invested in the Bank's international transaction currencies.

There are no equities in the Liquidity Portfolio and investment instruments include government bonds of eligible grade currencies issued by AAA–rated supranational and AAA–rated US agencies in eligible currencies; other liquid money market instruments are also eligible.

Types of Risk Exposure
The Bank's investment guidelines cover basic types of risk exposures, namely, market risk (currency risk, interest rate risk and equity price risk), credit risk, liquidity and instrument risk. These types of risk apply to the foreign assets and liabilities.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
December 31, 2015

30. **RISK MANAGEMENT IN RESPECT OF FINANCIAL INSTRUMENTS (Continued)**

((a) Currency Risk

The foreign exchange reserves are invested in currencies that are freely convertible, less susceptible to frequent and sharp exchange rate fluctuations and are used in well developed financial markets. The Bank's policy is to invest only in currencies with high ratings assigned by Moody's Investors Service and Standard and Poor's. Through a diversified currency allocation relative to an SDR weighted benchmark, the Bank ensures that the purchasing power of the foreign exchange reserves is preserved. In terms of the investment guidelines, a maximum deviation from the neutral level (using the SDR weights as a benchmark) for USD and EUR of 10 percentage points is permitted, while a deviation of up to 5 percentage points on all other currencies is permitted. At the end of 2015, the Bank's total exposure to SDR and related currencies was P81.2 billion (2014: P73.8 billion). The Bank is also exposed to SDR currency risk on net IMF balances amounting to P530 293 000 (2014: P475 751 000).

(b) Interest Rate Risk

Interest rate risk is the possible loss in the value of a fixed income asset resulting from an unexpected and adverse movement in interest rates and a consequent change in price. Interest rate risk is measured by modified duration, which measures the sensitivity of the price of a bond to changes in interest rates expressed in years. The Bank benchmarks the interest rate risk for the Pula Fund (fixed income assets) to reflect the long-term nature of the portfolio, with emphasis on higher return. The higher interest rate risk is generally compensated by higher returns expected from longer maturity bonds. The modified duration benchmark will vary over time, as changing market conditions and index weights impact the global modified duration of the index. At the end of 2015, the average modified duration of the fixed income portion of the Pula Fund was 7.4 years (2014: 7 years). As the Liquidity Portfolio gives priority to liquidity over return, given the constant need to provide foreign exchange to finance international transaction payments, from the Bank's perspective, this portfolio is exposed to minimum interest rate risk. At the end of 2015, the Liquidity Portfolio's average modified duration was 1.9 years (2014: 1.7 years).

(c) Equity Price Risk

Equity price risk is the risk that the value of equities decrease as a result of changes in the level of equity indices and diminution of value of individual stocks. The geographic allocation of equity exposure follows generally the market capitalisation among the major markets. The investment guidelines stipulate the holding levels of equities. Holdings of more than 5 percent in one company are not permitted. A reasonable spread among the industry sectors is maintained in the portfolio. There are no investments in private placements or unquoted stocks. At the end of 2015, the equity portion of the Pula Fund was P28.3 billion (2014: P23.8 billion).

Market Risk Sensitivity Analysis
The set of assumptions used for each of the risk factors hereunder are not forecasts, but merely "what if" scenarios and the likely impact on the current portfolio, based on selected changes in risk variables over a one year horizon.

The Table below gives an indication of the risk sensitivities of the portfolio to various risk parameters. Assuming that the probability of the beneficial change in the risk variables are as likely to happen as an adverse change, both potential increase and decrease are shown for the indicated scenarios.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
December 31, 2015

30. **RISK MANAGEMENT IN RESPECT OF FINANCIAL INSTRUMENTS (Continued)**

December 31, 2015

Risk Variable	Adverse market change			Beneficial market change	
		Scenario	Effect on Statement of Profit or Loss and Other Comprehensive Income[3] (P'000)	Scenario	Effect on Statement of Profit or Loss and Other Comprehensive Income[3] (P'000)
Interest Rate Risk		Increase in yields by 50 basis points	(1 384 841)	Decrease in yields by 50 basis points	1 384 841
Currency Risk	SDR currencies	Strengthening of the Pula by 1 percent	(830 182)	Weakening of the Pula by 1 percent	830 182
	South African rand	Strengthening of the Pula by 1 percent	(18 628)	Weakening of the Pula by 1 Percent	18 628
Equity Risk	Global Equities	Decline in global equity prices by 5 percent	(1 412 661)	Increase in global equity prices by 5 percent	1 412 661

December 31, 2014

Risk Variable	Adverse market change			Beneficial market change	
		Scenario	Effect on Statement of Profit or Loss and Other Comprehensive Income[5] (P'000)	Scenario	Effect on Statement of Profit or Loss and Other Comprehensive Income[3] (P'000)
Interest Rate Risk		Increase in yields by 50 basis points	(1 164 484)	Decrease in yields by 50 basis points	1 164 484
Currency Risk	SDR currencies	Strengthening of the Pula by 1 percent	(754 262)	Weakening of the Pula by 1 percent	754 262
	South African rand	Strengthening of the Pula by 1 percent	(36 851)	Weakening of the Pula by 1 percent	36 851
Equity Risk	Global Equities	Decline in global equity prices by 5 percent	(1 190 886)	Increase in global equity prices by 5 percent	1 190 886

The market risk estimates as presented in the Tables above are based on sensitivities to the individual risk factors. The correlation between the risk variables is not reflected in the effect on the Statement of Profit or Loss and Other Comprehensive Income.

(d) Credit risk

This is the risk that would arise if an entity that the Bank conducts business with is unable to meet its financial obligations or in the event of an adverse credit event or default. This may be a commercial bank accepting a deposit, a sovereign, supranational or corporate entity issuing a bond or a counterparty with whom the market participant has contracted to buy or sell foreign exchange or money or capital market instruments. In the Bank's endeavour to control credit risk, it deals with only the best quality institutions or counterparties, as determined by international rating agencies.

Consistent with the investment guidelines, the Bank withdraws the invested funds if there has been a downgrade of any institution. In cases where the new lower rating necessitates a lower exposure, funds are withdrawn to ensure that the new limit is not exceeded.

[5] The effects are expected to have the same impact on shareholder's funds.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
December 31, 2015

30. **RISK MANAGEMENT IN RESPECT OF FINANCIAL INSTRUMENTS (Continued)**

The Bank mitigates credit risk by addressing the following underlying issues:

- Defining eligible investment instruments;
- Pre-qualifying counterparties (financial institutions, brokers/dealers, and intermediaries) doing business with the Bank; and
- Diversifying investment portfolios so as to minimise potential losses from securities or individual issuers.

The Bank has not impaired any of its assets in the current and previous period.

Exposure to Credit Risk
The Table below shows the maximum exposure to credit risk for the components of the Statement of Financial Position, including derivatives. The maximum exposure is shown gross, before the effect of the above mitigation factors.

	Notes	2015 P'000	2014 P'000
Financial Assets			
Liquidity Portfolio			
Bonds: held for trading	1.1	12 904 792	9 559 860
Short-term deposits: loans and receivables		9 009 628	13 164 041
Pula Fund			
Bonds: available-for-sale	1.2	33 418 814	30 382 537
Derivative instruments: held for trading		30 233	8 273
Short-term deposits: loans and (payables)/receivables		(497 037)	557 506
International Monetary Fund- loans and receivables			
Reserve tranche	2.1	424 539	430 044
Holdings of Special Drawing Rights	2.2	1 334 931	1 178 929
General Subsidy Account	2.3	23 666	20 907
Government of Botswana bonds: available-for-sale	4	23 733	24 137
Other Assets- staff loans and advances: loans and receivables	5	52 579	49 663
Total		56 725 878	55 375 897
Analysis of Credit Exposure by class:			
Measured at fair value			
Bonds		46 323 606	39 942 397
Derivatives		30 233	8 273
Government of Botswana bonds		23 733	24 137
Measured at amortised cost			
IMF Reserves		1 783 136	1 629 880
Staff advances		52 579	49 663
Short-term deposits: loans and receivables		8 512 591	13 721 547
Total		56 725 878	55 375 897

While some financial instruments are recorded at fair value, the amounts shown above represent the current credit risk exposure, but not the maximum risk exposure that could arise in future as a result of changes in values. The Tables below reflect the credit exposure based on the fair value of the assets with counterparties as at December 31, 2015.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
December 31, 2015

30. **RISK MANAGEMENT IN RESPECT OF FINANCIAL INSTRUMENTS (Continued)**

Credit Exposure on Bonds

			2015	**2014**
Moodys/S&P Rating	Government (P'000)	Corporate (P'000)	Total (P'000)	Total (P'000)
AAA	38 061 986	487 543	38 549 529	33 638 471
AA+	351 374	58 557	409 931	2 046 855
AA	3 292 282	58 229	3 350 511	1 337 609
AA–	–	–	–	1 813 207
A+	2 176 371	19 171	2 195 542	–
A	–	30 370	30 370	203 125
Other[6]	1 779 227	8 496	1 787 723	903 130
	45 661 240	662 366	46 323 606	39 942 397

Credit Exposure to Banks (Short-term deposits)

	2015	**2014**
Fitch Rating	(P'000)	(P'000)
AAA[7]	2 975 442	2 298 545
AA+[7]	528 122	207 265
A+[7]	–	15 637
A+5	222 222	–
a+1	–	150 593
a1	562 492	806 870
a5	1 101 506	402 877
aa-1	–	4 216 276
aa-5	668 032	1 095 798
a-5	691 733	–
a-2	–	998 671
a-1	–	338 517
BBB[7]		2 117 242
BBB-[7]	1 278 130	–
bbb1/bbb2/bbb3/bbb+1/bbb-2/bbb-3/bbb-5	484 912	1 073 256
	8 512 591	13 721 547

Credit Exposure on Securities Lending Programme

The Bank's global custodian manages a securities lending programme as agent of the Bank. Due to the short term nature of the securities lending transactions, the collateral received under this programme changes on a short term basis. The securities lending is regulated by a securities lending agreement with the global custodian and follows the general criteria for the Bank's credit exposure. The global custodian monitors the market value of the collateral and, where necessary, obtains additional collateral in line with the underlying agreement.

(e) Instrument Risk

Sovereign Bonds

In accordance with the investment guidelines, the Bank invests in eligible instruments that are direct obligations or obligations explicitly guaranteed by governments or local governments of 13 selected sovereign countries that are highly rated by Standard and Poor's and Moody's Investors Service. Exposure limits are assigned to the specific sovereign countries in accordance with the ratings assigned by the credit rating agencies.

5.

6 'Other' includes investment rated below A-, but still rated investment grade as per the investment guidelines.

7 Included in AAA, AA$^+$, A$^+$, BBB and BBB$^-$ are deposits held with central banks.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
December 31, 2015

30. **RISK MANAGEMENT IN RESPECT OF FINANCIAL INSTRUMENTS (Continued)**

Corporate Bonds

The Bank invests in a small proportion of corporate bonds rated A1 or higher, with the issuer being incorporated and tax resident in a country whose sovereign debt is eligible for investment by the Bank. A reasonable geographical spread of issuers is maintained.

(f) Liquidity risk

Liquidity risk is the risk that the Bank will be unable to meet its payment obligations when they fall due, hence liquidity is an integral part of the Bank's foreign exchange reserves policy. To limit this risk, the Management manages the assets with liquidity in mind and monitors future cash flows and liquidity on a daily basis. The Bank is exposed to daily Pula liquidity requirements on the deposits it holds on behalf of the shareholder, Government of Botswana, the banking system and other clients holding deposits with the Bank (mainly parastatals). For the purpose of managing foreign exchange reserves, the Bank keeps some of its assets in short-term deposits and other liquid money market instruments to enable the availability of liquidity to meet outflows without incurring undue capital loss and to provide flexibility to respond effectively to changing market requirements.

Financial Liabilities at Undiscounted Cash Flows

The table below summarises the maturity profile of the Bank's financial liabilities as at December 31, 2015, based on contractual undiscounted repayment obligations.

December 31, 2015	Less than 3 months (P'000)	3–12 months (P'000)	1–5 years (P'000)	Over 5 years (P'000)	Total (P'000)
Bank of Botswana Certificates	8 192 650	–	–	–	8 192 650
Reverse Repurchase Agreements	1 672 849	–	–	–	1 672 849
Deposits	5 067 372	–	–	–	5 067 372
Allocation of SDR – IMF	–	–	–	893 912	893 912
Liabilities to Government – IMF	–	–	–	358 931	358 931
Dividend to Government	401 782	–	–	–	401 782
Other Liabilities	129 509	–	–	–	129 509
	15 464 162			1 252 843	16 717 005

December 31, 2014	Less than 3 months (P'000)	3–12 months (P'000)	1–5 years (P'000)	Over 5 years (P'000)	Total (P'000)
Bank of Botswana Certificates	4 208 000	–	–	–	4 208 000
Reverse Repurchase Agreements	304 357	–	–	–	304 357
Deposits	6 841 828	–	–	–	6 841 828
Allocation of SDR – IMF	–	–	–	789 694	789 694
Liabilities to Government – IMF	–	–	–	364 435	364 435
Dividend to Government	544 689	–	–	–	544 689
Other Liabilities	214 974	–	–	–	214 974
	12 113 848	–	–	1 154 129	13 267 977

(g) External Fund Managers and Custody

External fund managers are engaged to complement the Bank's reserve management activity. The Bank uses the services of a custodian which provides custodial services for the Bank's assets.

(h) Operational Risk

Operational risk is the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications or lead to financial loss. The Bank cannot expect to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks, the Bank is able to manage the risks. The Bank has a Risk Management and Planning Division within the Finance Department which focuses primarily on operational risk and coordination of the business continuity management.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
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31. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value of financial instruments carried at amortised cost

The Board considers that the carrying amounts of financial assets and liabilities recognised in the financial statements at amortised cost approximate their fair values.

For financial instruments that trade infrequently and have little price transparency, fair value is less objective and requires varying degrees of judgement depending on liquidity, concentration, uncertainty of market factors, pricing assumptions and other risk affecting the specific instrument.

Valuation models and techniques

The fair values of financial assets and financial liabilities with standard terms and conditions and traded on active liquid markets are determined with reference to quoted market prices (includes listed redeemable notes, bills of exchange, debentures and perpetual notes).

The fair values of other financial assets and financial liabilities (excluding derivative instruments) are determined in accordance with generally accepted pricing models and valuation techniques. The fair values are based on net present value, discounted cash flow models and comparison with prices from observable current market transactions and dealer quotes for similar instruments.

The objective of valuation techniques is to arrive at a fair value measurement that reflects the price that would be received to sell the asset or paid to transfer the liability in an orderly transaction between market participants at the measurement date.

The Bank uses widely recognised valuation models for determining the fair value of financial instruments, such as interest rates yields, that use only observable market data and require little management judgement and estimation.

The fair value of Government bonds is derived from market quotations. These are prices dealers will be willing to pay for similar instruments.

The Bank uses discounted cash flow analysis to value Bank of Botswana Certificates (BoBCs). The valuation is based on observable market prices, with the yield curve providing the discount factors needed.

The fair values of derivative instruments are calculated using quoted prices. Where such prices are not available, a discounted cash flow analysis is performed using the applicable yield curve for the duration of the instruments for non-optional derivatives, and option pricing models for optional derivatives.

Foreign currency forward contracts are measured using quoted forward exchange rates and yield curves derived from quoted interest rates matching maturities of the contracts. Interest rate swaps are measured at the present value of future cash flows estimated and discounted based on the applicable yield curves derived from quoted interest rates.

Fair values are categorised into different levels in a fair value hierarchy, which reflects the significance of the inputs used in making the measurements.

Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less active; or other valuation techniques in which all significant inputs are directly or indirectly observable from market data.

Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

NOTES TO THE ANNUAL FINANCIAL STATEMENTS (Continued)
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31. FAIR VALUE OF FINANCIAL INSTRUMENTS (Cont'd)

If the inputs used to measure the fair value of an asset or a liability are categorised in different levels of the fair value hierarchy, then the fair value measurement is categorised in its entirety in the same level of the fair value hierarchy as the lowest level input that is significant to the entire measurement.

Fair Value Measurements recognised in the Statement of Financial Position
The following Table provides an analysis of financial instruments that are measured at fair value, including their levels in the fair value hierarchy.

December 31, 2015	Note	Level 1 P'000	Level 2 P'000	Total P'000
Financial Assets				
Held for trading				
Bonds		12 904 792	–	12 904 792
Derivative instruments		–	30 233	30 233
Available-for-sale				
Bonds		33 418 814	–	33 418 814
Equities		28 253 210	–	28 253 210
Government Bonds		–	23 733	23 733
Loans and Receivables		–	10 348 306	10 348 306
		74 576 816	10 402 272	84 979 088
Financial Liabilities				
Held for trading				
Derivative instruments		–	21 770	21 770
Other financial liabilities				
Bank of Botswana Certificates		–	8 189 922	8 189 922
Other liabilities		–	8 525 934	8 525 934
			16 737 626	16 737 626

December 31, 2014	Note	Level 1 P'000	Level 2 P'000	Total P'000
Financial Assets				
Held for trading				
Bonds	13.1	9 559 860	–	9 559 860
Derivative instruments	13.1	–	8 273	8 273
Available–for–sale				
Bonds	13.1	30 382 537	–	30 382 537
Equities	13.1	23 817 720	–	23 817 720
Government Bonds	13.1	–	24 137	24 137
Loans and Receivables	13.1	–	15 401 090	15 401 090
		63 760 117	15 433 500	79 193 617
Financial Liabilities				
Held for trading				
Derivative instruments	13.2	–	8 512	8 512
Other financial liabilities				
Bank of Botswana Certificates	13.2	–	4 201 384	4 201 384
Other liabilities	13.2	–	9 059 977	9 059 977
		–	13 269 873	13 269 873

There were no transfers between levels during the year.

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32. **RELATED PARTY BALANCES AND TRANSACTIONS**

Balances and Transactions with the Government
The Bank provides several services to its shareholder, the Government. The main services during the year to December 31, 2015, were:

(a) provision of banking services, including holding of the principal accounts of the Government;

(b) management of the Notes and Coin in issue, including printing and minting of notes and coin; and

(c) being the Government agent for government bonds and treasury bills.

The aggregate balances in Government accounts are disclosed in Note 10.

No charge is made to the Government for provision of these services.

The Bank earned interest on its holding of the Government of Botswana bonds (as described in Note 4) of P1 997 000 (2014: P2 000 000).

Other Related Party Balances and Transactions
(a) Amounts due to related parties.

Included in the balance of outstanding "Deposits – Other" in Note 10 are the following balances with Government-owned institutions.

	2015 P'000	2014 P'000
Botswana Savings Bank	1 172	1 781
Botswana Unified Revenue Service	72 872	535 074
Total	74 044	536 855

The amounts outstanding are unsecured and have no fixed repayment terms.

(b) Remuneration of Key Management Personnel

Key management personnel comprise the Governor, Board Members, Deputy Governors, General Manager and Heads of Department.

Gross emoluments of the key management personnel are:

	2015 P'000	2014 P'000
Non-Executive Board members	214	59
Executive Management		
Salaries, allowances and other short term benefits	13 252	10 988
Post-employment benefits	2 356	2 004
	15 822	13 051

Of the Staff Loans and Advances per Note 5, P1 682 000 (2014 : P1 377 000) are attributable to Executive Management.

33. **CONTINGENCIES**

The Bank is defending an action brought by one of the depositors of Kingdom Bank Africa Limited that is now under liquidation. Although liability is not admitted, if the defence against the action is unsuccessful, the claim against the Bank and legal costs could amount to the equivalent of approximately P34 million.

34. **EVENTS AFTER THE REPORTING DATE**

At the date of finalisation of the annual financial statements, there were no material events that occurred subsequent to the statement of financial position date that require adjustment to or disclosure in the financial statements.

Part B

The Botswana Economy in 2015 and Theme Chapter

Bank of Botswana

Chapter 1

The Botswana Economy in 2015

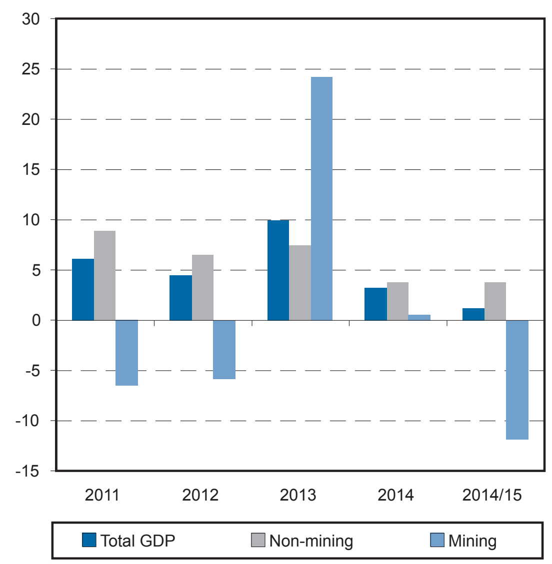
1. Output, Employment and Prices

(a) National Income Accounts

Overview

1.1 In the twelve months to September 2015, GDP growth is estimated at 1.2 percent, compared to 3.2 percent in 2014.[1] Output growth was attributable to the performance of the non-mining sectors (Chart 1.4), which grew by 3.7 percent, with strong performance of *trade, hotels and restaurants* (6.7 percent), *transport and communications* (5.4 percent), *general government* (5.1 percent) and *social and personal services* (3.8 percent). In contrast, *mining* output fell by 11.8 percent compared to the previous year's growth rate of 0.5 percent (Chart 1.1). Although the mining sector continues to account for the largest share of GDP at 21.3 percent, there is a long-term decline relative to the rest of the economy (Chart 1.2).[2]

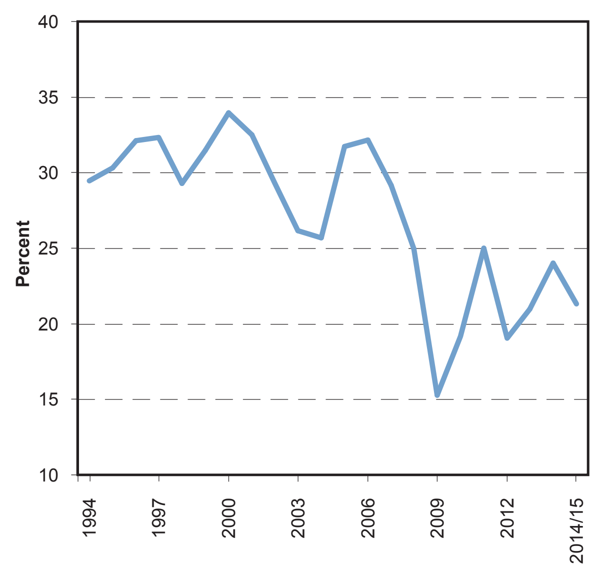
Chart 1.1: Real GDP Growth 2011 - 2014/15 (Percent)



1. Data for 2014/15 are for the 12-month period to September 2015.

Source: Statistics Botswana

Chart 1.2: Share of Mining in Total GDP (Percent)



1. Measured in current prices.

Source: Statistics Botswana

Sectoral Performance

1.2 The 11.8 percent contraction in *mining* output was mainly due to a 12.2 percent decline in diamond production which was scaled down in response to subdued global demand. Thus, Debswana produced only 20.4 million carats of rough diamonds in 2015, which was 16 percent lower than in the previous year. Among other diamond producers, the Karowe mine continued to perform well, boosted by discovery and sale of exceptional, large, high-value stones,[3] for which the demand remains strong. Gem Diamond's Ghaghoo

1 Estimates for the final quarter of 2015 are yet to be published. Comparison between the twelve months to September 2015 with the calendar year 2014 includes an overlap of one quarter.

2 This is based on the current price measure of GDP. In constant prices, mining is no longer the largest sector of the economy, due to the relatively low prices of rough diamonds prevailing in 2006, the base year currently used for measuring real GDP.

3 In 2015, the mine discovered the world's second largest diamond of 1 111 carats.

mine, continued to build up production, although progress towards operating at full capacity was disrupted by challenges in the underground infrastructure and, subsequently falling demand for rough diamonds. In contrast, operations at the small Lerala mine remained suspended during the year.[4] Production of copper-nickel declined by 14.5 percent, following the closure of the Boseto mine and the mines operated by Messina Copper. Furthermore, production at the BCL and Tati Nickel mines was badly affected by the temporary closure for maintenance of the mines' shared smelter facility.[5] Output of *coal* expanded by 15.8 percent, in part reflecting demand for exports, while the production of soda ash declined by 15.7 percent, from the high output levels of the previous year; *other mining* contracted by 14.2 percent.

1.3 Performance of *trade, hotels and restaurants* led the non-mining sectors with growth of 6.7 percent, albeit lower than the 7.1 percent expansion in the previous year. Overall sectoral performance benefitted from increased activity for *hotels and restaurants* (6.5 percent) and *retail* and *wholesale* activity (6.3 percent and 6.2 percent, respectively), with the latter indicative of continuing expansion of domestic demand, including from government spending.[6] However, there was some indication that the number of international visitors was negatively affected by the continuing adverse publicity arising from the 2014 Ebola outbreak in West Africa together with the strengthening of the US dollar, the currency in which Botswana tourist destinations are often priced.

1.4 Growth in *transport and communications* decelerated to 5.4 percent from 7.4 percent in 2014. Expansion of *communications* remained strong at 6.4 percent, while all the main *transport* sub-sectors also recorded positive growth, with the exception of *air transport*, which contracted by -6.1 percent compared to -3.6 percent in 2014.

1.5 *Manufacturing* increased at a moderate rate of 3.7 percent in the twelve months to September 2015, underpinned by positive growth of *other manufacturing* (4.0 percent), and *beverages* (0.8 percent), while *meat and meat products* recorded negative growth. Growth in *construction* was 3.5 percent, up from 2.8 percent in 2014. Construction activity was supported by government spending on major infrastructure projects and continuing private sector development of residential, commercial and retail property. Continuing growth in cement imports (a key leading indicator of construction) during 2015 also points to some pick-up in construction activity. *Finance and business services* growth picked up slightly to 2.7 percent from 2.4 percent recorded in the previous year, led by *banks, insurance* and *real estate* but counteracted by slower growth in *business services*.

1.6 *Agriculture* grew marginally by 0.6 percent, with expansion in the *livestock* sub-sector (4.7 percent) largely offset by reduced output for *crops* (-0.5 percent) and *other agriculture* (-8 percent). Production was negatively affected by drought that continued into 2016, aggravated by El Nino-induced dry weather patterns.

1.7 Value added by *water and electricity* contracted further by 91.7 percent in the twelve months to September 2015, following a 55.8 percent decline in the previous year (Chart 1.3). The contraction is largely attributable to the *electricity* sub-sector, despite the easing of power shortages from the second quarter of 2015 as generation at the Morupule B power station stabilised and an additional diesel power plant augmented supply.[7] Performance of the *water* sub-sector was severely constrained by unprecedented water shortages in the more heavily-urbanised southeast of the country.

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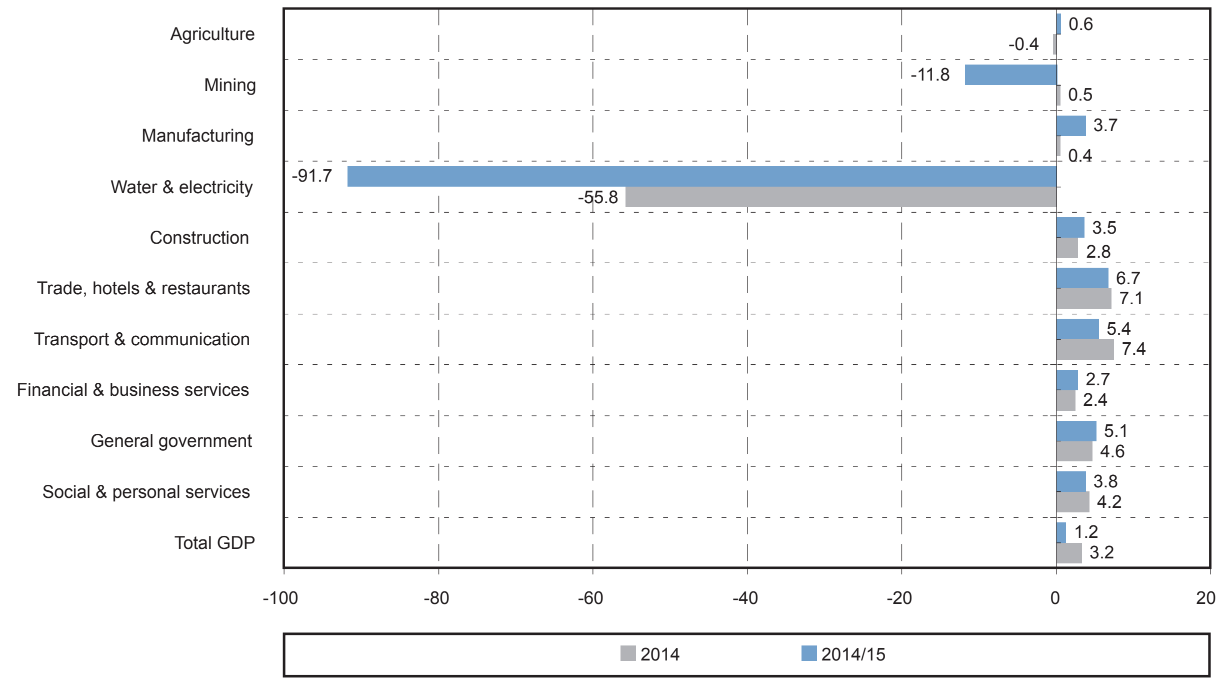
4 Kimberly Diamonds has received funding to re-commission the Lerala mine, which is expected to take place during the course of 2016, with the mine projected to produce approximately 357 000 carats per annum over a seven-year life span.

5 Although planned, the maintenance took longer than expected, putting severe strain on the viability of both mines' operations.

6 A further sign of robust consumer spending is the 11.9 percent annual growth (in mid-2015) in the number of passenger vehicles registered in Botswana.

7 With improved supply, the increasingly negative contribution is a reflection of the continuing heavy imbalances between the costs of service provision and the associated tariffs.

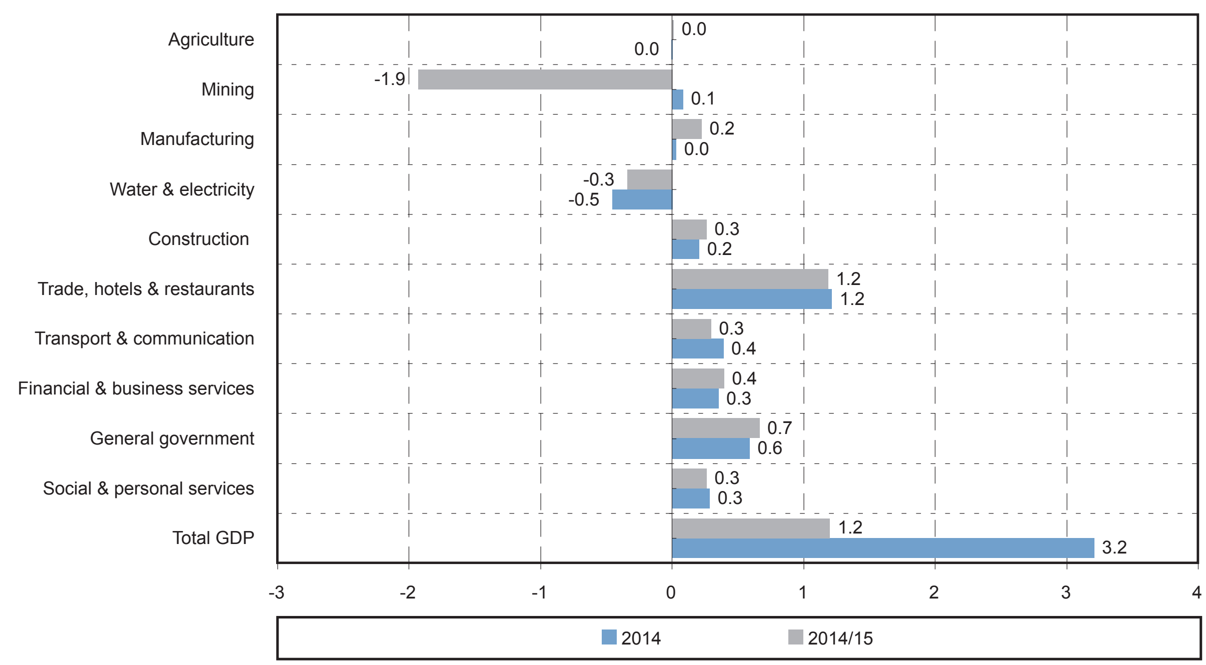
CHART 1.3: REAL GDP GROWTH BY SECTOR - 2014/15 (PERCENT)



1. Data for 2014/15 are for the 12-month period to September 2015.

Source: Statistics Botswana

CHART 1.4: CONTRIBUTION TO REAL GDP GROWTH BY SECTOR (PERCENT)



1. Data for 2014/15 are for the 12-month period to September 2015.

Source: Statistics Botswana

(b) Domestic Economic Outlook

1.8 The sluggish performance in the global economy continues to constrain prospects for growth in Botswana. World output is projected to increase by 3.4 percent in 2016, which is marginally higher than 3.1 percent in 2015 (Table 1.1),[8] but lower than earlier forecasts. The recent fall in global oil prices is expected to

8 World Economic Outlook (WEO) Update, January 2016, International Monetary Fund.

provide some stimulus to the global economy; however, subdued global demand for diamonds continues to constrain activity in Botswana's mining sector. Within the region, deterioration in the growth outlook for South Africa will adversely affect performance in neighbouring countries, including Botswana.

Table 1.1: Global Growth 2014 – 2016 (Percent)

	2014	2015	Projections 2016
Global	3.4	3.1	3.4
Advanced economies, of which,	1.8	1.9	2.1
USA	2.4	2.5	2.6
Euro area	0.9	1.5	1.7
Japan	0.0	0.6	1.0
Emerging markets and Developing Economies,	4.6	4.0	4.3
of which, Sub-Saharan Africa	5.0	3.5	4.0
China	7.3	6.9	6.3
India	7.3	7.3	7.5
Botswana	3.2	1.0	4.2

Source: International Monetary Fund, *World Economic Outlook,* January 2016

1.9 For the domestic economy, growth of 1 percent was recorded in 2015 while 4.2 percent is projected for 2016, although the extent of the slowdown in mining means that the forecast for 2016 could be optimistic. Government expenditure will continue to support domestic activity.[9] However, continued underspending and significant import content, especially on the development budget, could moderate this effect. In addition, other bottlenecks, including water and electricity shortages, together with fragile confidence among local businesses, could constrain activity in the private sector, which is necessary if medium-term growth projections are to be achieved.

(c) Inflation

1.10 Global inflation was benign in 2015, having decreased from 3.5 percent in 2014 to 3.3 percent due to weak global demand, persistent excess capacity in major economies as well as low commodity prices. International oil prices decreased markedly, reaching a six-year low in December 2015 against the backdrop of a well-supplied market and modest global demand. The price of Brent crude, which is the major international benchmark, fell by 39 percent from USD62.34 per barrel in December 2014 to USD38.01 in December 2015.[10] In the same period, the average world food price index[11] declined by 17.1 percent from 185.8 to 154.1.

1.11 For Botswana's trading partner countries, trade-weighted average inflation declined from 3.1 percent in December 2014 to 2.8 percent in 2015. Inflation for SDR countries (USA, UK, Japan and euro area) decreased slightly from an average of 0.5 percent to 0.4 percent in the same period, while headline inflation in South Africa fell from 5.3 percent to 5.2 percent, and remained within the South African Reserve Bank's medium-term target range of 3 – 6 percent (Chart 1.5).

1.12 Inflation fluctuated around the lower end of the Bank's medium-term objective range of 3 – 6 percent in 2015[12] and decreased from 3.8 percent in December 2014 to 3.1 percent in December 2015. Price developments were in the context of modest domestic demand, including restrained growth in personal incomes, a reduction in fuel prices, moderate increase in other administered prices and low food price inflation, which also benefited from additional value added tax (VAT) concessions. External pressures on domestic prices were also restrained owing to low and declining inflation in trading partner countries and the appreciation of the Pula against the rand (which reduced imported inflation). In particular, food price inflation

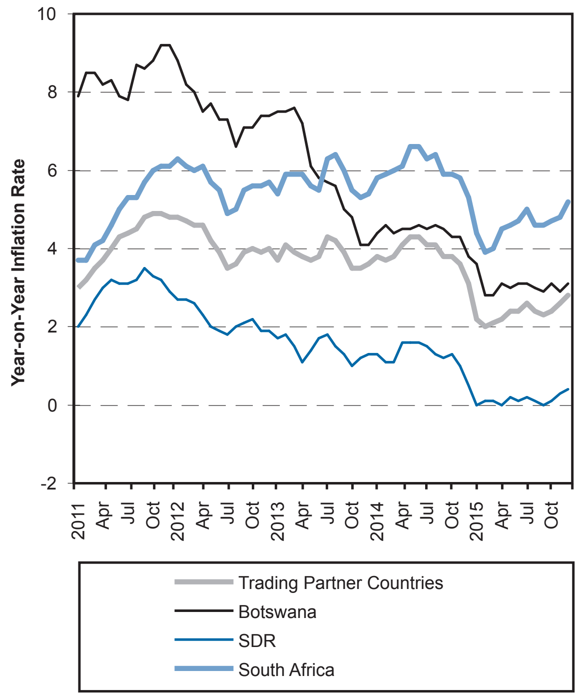
9 Projects under the Economic Stimulus Programme are covered with the government expenditure budget that is 2.7 percent lower than in the previous fiscal year.

10 Another major benchmark, West Texas Intermediate, averaged USD37.19 per barrel in December 2015, which was a decrease of 37.3 percent from USD59.29 per barrel in December 2014. Meanwhile, the Organisation of Petroleum Exporting Countries' (OPEC) reference crude oil basket declined by 43.4 percent from USD59.46 per barrel to USD33.64 per barrel in the same period.

11 Food Price Index compiled by the United Nations' Food and Agriculture Organisation.

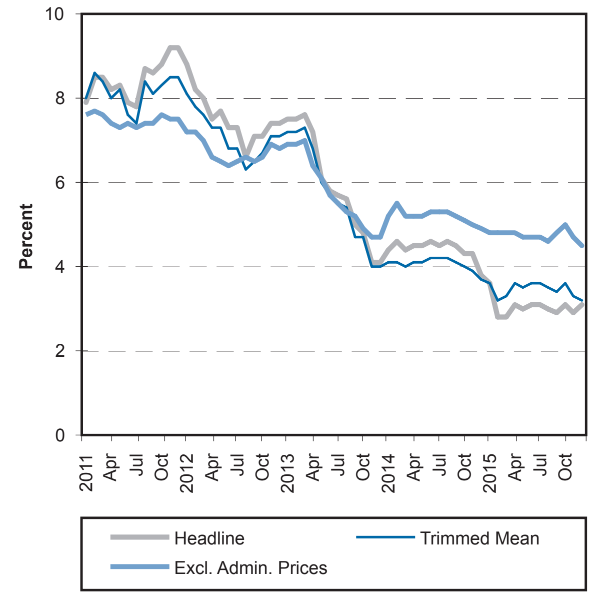
12 There was a breach of the lower bound of the objective range on four occasions, in February and March (2.8 percent) and in September and November 2015 (2.9 percent). For the year as whole, average inflation was 3 percent.

CHART 1.5: BOTSWANA AND TRADING PARTNER COUNTRIES' INFLATION (2011 - 2015)



Source: Statistics Botswana, Bank of Botswana and Bloomberg

CHART 1.6: BOTSWANA HEADLINE AND CORE INFLATION (2010 – 2015)



Source: Statistics Botswana.

eased from 2.5 percent in December 2014 to 0.7 percent in December 2015,[13] while fuel prices fell by 15.7 percent in the same period. The core measures of inflation, 16 percent trimmed mean and inflation excluding administered prices, decreased from 3.7 percent and 4.9 percent in December 2014 to 3.2 percent and 4.5 percent in December 2015, respectively.

(d) Inflation Outlook

1.13 Global inflation is forecast to be 3.4 percent in 2016, marginally higher than the 3.3 percent recorded in 2015, against the background of low commodity prices, weak demand and persistent spare capacity in advanced economies. In Botswana, it is anticipated that non-mining output growth will continue to be below trend, as constrained by electricity and water supply shortages and modest growth in major trading partners. Pressure on inflation from domestic factors is expected to be limited due to restrained growth in personal incomes and, overall, it is projected that domestic inflation will remain within the 3 – 6 percent objective range in the medium term. Upside risks to the inflation outlook relate to any substantial upward adjustment in administered prices and government levies and any increase in international food and oil prices beyond current projections. In addition, there is a risk that food price inflation could increase in the context of drought in the region and at a time when the base effects of the reduction in VAT for key food items in 2015 are dissipating. Nevertheless, there are downside risks arising from continuing low global growth and resulting decrease in commodity prices that could lead to lower inflation than currently projected.

2. PUBLIC FINANCE AND THE 2016/17 BUDGET[14]

2.1 The Government budget for 2016/17 marks the end of the extended National Development Plan 10 and transition from Vision 2016 to Vi-

13 The amendments to the Value Added Tax Act that came into effect at the beginning of 2015 extended the range of goods that are zero rated to include additional staple foodstuffs, thus reducing that component of food prices.

14 The figures reported for Government debt are taken from Table V of the *Financial Statements, Tables and Estimates of the Consolidated and Development Funds Revenues*. These may differ in some instances from those included in the *Budget in Brief*.

sion 2036; at the same time, there is a global move from the United Nations' Millennium Development Goals (MDGs) to the Sustainable Development Goals (SDGs). The budget was presented in the context of continued sluggish growth in the global economy and falling commodity prices which have severely affected Government revenues and resulted in a projected budget deficit of P4.2 billion (2.7 percent of GDP) and P6 billion or 3.8 percent of projected GDP for 2015/16 and 2016/17, respectively.[15] In response to the recent slowdown of the domestic economy, the Government introduced the Economic Stimulus Programme (ESP), subsumed within the budget, to boost economic activity and employment creation.[16] The budget priorities for 2016/17 are, therefore, aligned with the interrelated objectives of the ESP, NDP 11, Vision 2036 and the SDGs. Thus the 2016 Budget Speech emphasised the priorities of infrastructure investment; creating employment opportunities; strengthening human capital; enhancing national security; strengthening local governance; and establishing a path towards sustainable economic development.

(a) Budget Performance: 2014/15 and 2015/16

2014/15 Budget Outturn

2.2 The budget outturn for the 2014/15 financial year was a surplus of P5.3 billion, significantly higher than the revised estimate surplus of P281 million.[17] This was mostly attributable to a combination of higher revenue and underspending (Table 1.2).

2.3 Revenue[18] increased by P7 billion (14.2 percent) in 2014/15 to P56 billion, underpinned by higher mineral revenues and payments from the Southern African Customs Union (SACU). Non-mineral income tax, VAT and revenue from the Bank of Botswana also increased significantly. Total expenditure and net lending also rose from P41.7 billion in the previous year to P50.6 billion, but was slightly below the revised estimate of P51.3 billion. The shortfall in total spending was due to under-expenditure of recurrent and development budgets, which were below the revised estimates by P278 million and P406 million, respectively.

2015/16 Revised Estimates

2.4 The revised estimates of the budget for 2015/16 shows a deficit of P4.2 billion, compared to the original projection of a surplus of P1.2 billion. This is due to a combination of additional funding, in particular for the development budget, together with a shortfall in revenue. However, due to the sharp reduction in mineral revenues, the deficit as at December 2015 (nine months of the fiscal year) was P8 billion, thus indicating that the final deficit could be larger than indicated in the revised estimates.

2.5 The revised estimates show reduced revenue of P51.8 billion due to a downward revision by 6.5 percent from P55.4 billion in the original budget as a result of lower receipts from minerals, SACU and VAT. The estimate for expenditure and net lending has been revised upwards from P54.2 billion to P56 billion. The increase comprises additional spending in the recurrent and development budgets of P423 million and P1.4 billion, respectively, with the latter mainly to meet the additional costs of addressing water and electricity shortages.

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15 Ministry of Finance and Development Planning GDP projections.

16 This is a public expenditure driven programme intended primarily to accelerate NDP 10 projects and programmes that were deferred due to the global financial crisis and economic recession, with a particular emphasis on providing opportunities for local businesses and job creation, especially for the youth. The ESP projects are expected to run for a period of three years, with P1.4 billion and P2.2 billion so far allocated for 2015/16 and 2016/17, respectively. Beyond the initial phase of infrastructure development, targeted sectors include: agricultural production, tourism development, the Economic Diversification Drive (EDD), manufacturing, construction and maintenance of buildings and roads, reskilling of youth and the establishment of Special Economic Zones (SEZs).

17 Botswana Government, 2016 Budget Speech.

18 Total revenue includes grants.

TABLE 1.2: GOVERNMENT BUDGET 2014/15 – 2016/17 (P MILLION)

	2014/15			2015/16		2016/17
	Budget	Revised	Final	Budget	Revised	Budget
Revenue	**50 183**	**51 544**	**55 904**	**55 382**	**51 764**	**48 398**
Mineral Revenue	15 241	17 243	21 532	20 144	18 299	17 033
Non-Mineral Revenue	34 942	34 301	34 372	35 238	33 465	31 365
Expenditure	**48 857**	**51 263**	**50 564**	**54 153**	**55 961**	**54 445**
Recurrent Expenditure	36 693	37 861	37 583	41 296	41 719	39 699
Personal Emoluments	15 749	16 377	16 589	16 057	16 072	18 107
Grants & Subventions	9 809	9 930	10 597	10 864	10 969	10 986
Public Debt Interest	907	907	702	1 079	1 079	736
Other Charges	10 228	10 647	9 696	13 296	13 600	9 871
Development Expenditure	12 240	13 478	13 072	12 933	14 318	14 821
Net Lending	-76	-76	-91	-76	-76	-76
Balance	**1 326**	**281**	**5 340**	**1 229**	**-4 197**	**-6 046**

Source: Ministry of Finance and Development Planning

(b) The 2016/17 Budget Proposals

2.6 The proposed budget allocations for 2016/17 were mainly informed by the need to stimulate economic growth and employment creation. However, spending will be implemented with prudence to ensure fiscal sustainability in the medium-term. The anticipated budget deficit of P6 billion will be financed by drawing down Government savings and through domestic and foreign borrowing. In addition to existing legislation that puts a ceiling on Government debt, it was indicated that future budget deficits would be limited to a maximum of 4 percent of GDP.

Revenue

2.7 Revenue for 2016/17, including grants, is projected to be P48.4 billion, which is 6.5 percent lower than the revised budget for 2015/16 (Table 1.3) and reflects the uncertain economic outlook. In this regard, mineral receipts will fall by 6.9 percent from P18.3 billion in 2015/16 to P17 billion in 2016/17, but will remain the largest source of revenue, representing 35.2 percent of the total. Receipts from SACU are also forecast to decrease from P15.5 billion to P11.8 billion, equivalent to 24.3 percent of total revenue. The substantial reduction in the two major sources of government revenue, which together account for 59.5 percent of the total, highlights the need to further diversify the revenue base. Non-mineral income tax is projected to increase by 9.8 percent to P10.3 billion, thus accounting for 21.2 percent of budgeted revenue; VAT collections are also expected to grow by 10.1 percent to P6 billion (12.4 percent of total revenue) in 2016/17.

Expenditure

2.8 Total expenditure and net lending for 2016/17 is budgeted at P54.4 billion, which is a decrease of 2.7 percent from P56 billion in the revised estimates for 2015/16 (Table 1.3). Recurrent expenditure is projected to decline by 4.8 percent, from P41.7 billion to P39.7 billion, and account for 72.9 percent of total spending. In contrast, development spending is expected to grow by 3.5 percent from a revised P14.3 billion in 2015/16 to P14.8 billion in 2016/17.

2.9 The bulk of recurrent spending, P18.1 billion (45.6 percent), is on personal emoluments, which includes wages and salaries as well as pensions and gratuities. The balance is accounted for by grants and subventions to parastatals and local authorities which amount to P11 billion (27.7 percent), "other charges" at P9.9 billion (24.9 percent), and interest on public debt at P736 million (1.9 percent). By ministerial allocation, Education has the largest share of the recurrent budget (26.8 percent). Health, Local Government and Rural Development, Defence, Justice and Security and Transport and Communication account for 14.5 percent, 12.6 percent, 12.5 percent and 5.1 percent, respectively, of recurrent expenditure.

2.10 As indicated in the 2016 Budget Speech, the main focus of the development budget is towards enhancing national security, sustaining ongoing major infrastructure projects and using ESP to fast-track completion of projects that had previously been postponed. Thus, P3.6 billion (24.2 percent of the development budget) was allocated to the Ministry of Defence, Justice and Security, while P3.4 billion (23.1 percent) was allocated to the Ministry of Minerals, Energy and Water Resources, and includes P1.7 billion for the Botswana Power Corporation (BPC).[19] The Ministry of Transport and Communications was allocated the third highest share of 9.5 percent or P1.4 billion, mostly to finance ICT, road and air transport infrastructure. The budget allocation to the Ministry of Local Government and Rural Development was 8.2 percent and amounts to P1.2 billion, the bulk of which is for the Ipelegeng and Destitute programmes, together with funding for village infrastructure and primary school construction projects.

Debt Management

2.11 Government and government-guaranteed debt as at the end of the 2015/16 fiscal year is projected at P33.8 billion,[20] of which P25.2 billion is Government's own debt, while the balance is government-guaranteed debt (Table 1.4). External debt amounts to P25.1 billion. The P8.7 billion of internal debt includes P8.1 billion of government securities, with the balance being of guarantees. Overall, total projected debt as at March 31 2015 is equivalent to 22 percent of forecast GDP, thus below the statutory ceiling of 40 percent of GDP.[21]

Table 1.3: Government Budget 2011/12 – 2016/17

Fiscal Years (FY)	**2011/12**	**2012/13**	**2013/14**	**2014/15**	**2015/16**	**2016/17**
GDP current prices, (P Million)	109 481	113 674	129 425	145 435	153 844	159 888
Nominal GDP Growth (Percent)	19.4	3.8	13.9	12.4	5.8	3.9
				Budget	**Revised Budget**	**Budget**
Revenue & Grants	38 486	41 658	48 951	55 904	51 764	48 398
Recurrent Expenditure	28 836	32 106	33 220	37 583	41 719	39 699
Development Expenditure	9 956	8 280	8 909	13 072	14 318	14 821
Net Lending	-124	351	-399	-91	-76	-76
Expenditure & Net Lending	38 667	40 736	41 730	50 564	55 961	54 445
Balance	-181	922	7 222	5 340	-4 197	-6 046
Share of GDP (percent)						
Revenues & Grants	35.2	36.6	37.8	38.4	33.6	30.3
Recurrent Expenditure	26.3	28.2	25.7	25.8	27.1	24.8
Development Expenditure	9.1	7.3	6.9	9.0	9.3	9.3
Expenditure & Net Lending	35.3	35.8	32.2	34.8	36.4	34.1
Balance	-0.2	0.8	5.6	3.7	-2.7	-3.8

Source: Ministry of Finance and Development Planning

19 This is to cover the costs of both the emergency power supply programme and expansion of rural electrification.

20 An increase of 2.1 percent compared to the balance outstanding at the end of 2014/15 fiscal year.

21 Most figures reported for Government debt are taken from Table VII of the Financial Statements, Tables and Estimates of the Consolidated and Development Funds Revenues. These may differ in some instances from those included in the Budget in Brief.

TABLE 1.4: GOVERNMENT DEBT AND GUARANTEES FOR 2014/15 – 2015/16 (P MILLION)

Debt & Liabilities as at March 31, 2015	External	Internal	Total
External Debt	17 981		
External Contingent Liabilities	7 160		
Internal Debt		7 466	
Internal Contingent Liabilities		520	
Total Debt & Contingent liabilities as at March 31, 2015	**25 141**	**7 986**	**33 127**
GDP for FY 2014/15			145 435
Debt as percentage of GDP	17.3	5.5	22.8
Total Debt & Contingent Liabilities anticipated March 31, 2016	**25 070**	**8 731**	**33 801**
GDP forecast for FY 2015/16			153 844
Debt as percentage of GDP	16.3	5.7	22.0

Source: Ministry of Finance and Development Planning

3. EXCHANGE RATES, BALANCE OF PAYMENTS AND INTERNATIONAL INVESTMENT POSITION

(a) Exchange Rates

3.1 The exchange rate policy aims at supporting competitiveness of domestic industries in the international and domestic markets, thus contributing to the national objectives of economic diversification and employment creation. This is achieved through maintaining a stable real effective exchange rate (REER)[22] of the Pula against a basket of currencies of major trading partner countries. In 2015, the weights of the currencies in the Pula basket were 50 percent each for the South African rand and the International Monetary Fund's Special Drawing Rights (SDR), thus reflecting the country's trade patterns.

3.2 Consistent with the policy objective of maintaining a stable REER of the Pula, the Bank implemented a zero rate of crawl of the NEER as the projected domestic inflation was close to the lower end of the medium-term inflation objective and similar to the trading partner countries' forecast average inflation. Consequently, the trade-weighted NEER of the Pula was stable in the twelve months to December 2015 and given the small difference between inflation in Botswana and in trading partner countries, the REER was similarly largely constant (marginal 0.4 percent appreciation) in the year to December 2015. Although the REER is a measure of competitiveness, it should be noted that stability of the exchange rate alone is not sufficient to ensure the competitiveness of local producers. The attainment of durable improvement in competitiveness of domestic producers is mainly through increased productivity, which also contributes to lower inflation.

(b) Balance of Payments

3.3 The balance of payments was in overall deficit of P57 million in 2015, compared to a surplus of P11.4 billion in 2014 (Chart 1.7 and Table 1.6). The deficit was attributable to deterioration in the trade balance, as exports of rough diamonds slowed sharply in 2015.Current Account[23]

3.4 The current account surplus is estimated at P11.3 billion in 2015 compared to a revised P22.2 billion in 2014. The lower surplus is primarily the result of a merchandise trade deficit, arising mainly from the decline in mineral exports that was only partly offset by rising inflows from SACU and net service receipts.

Merchandise Trade[24]

3.5 Trends in merchandise trade continue to be

22 The REER is a trade-weighted exchange rate of the Pula (against a fixed basket of currencies, after allowing for relative inflation). It is used as an indicator of the relative competitiveness of the country's tradeable goods and services.

23 The current account comprises trade in goods and services, the income account and the net current transfers.

24 Note that the trade data used in preparing the balance of

driven by the aggregation and sales functions of De Beers that relocated to Botswana in 2012,

Table 1.5: Pula Exchange Rates Against Selected Currencies

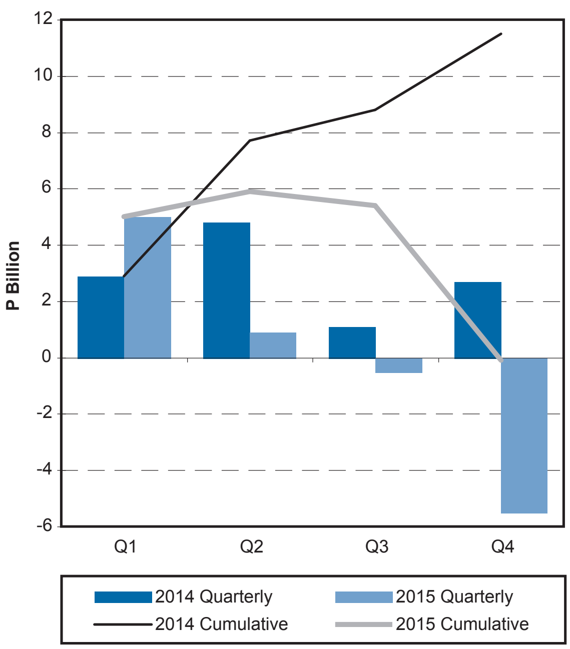
Nominal Exchange Rates (Foreign Currency per Pula)			
As at end of Currency	2014	2015	Change (Percent)
SA rand	1.2169	1.3830	13.6
US dollar	0.1051	0.0890	-15.3
British pound	0.0675	0.0600	-11.1
Japanese yen	12.58	10.72	-14.8
SDR	0.0726	0.0642	-11.6
Euro	0.0865	0.0814	-5.8
NEER (index, Sept. 2006 = 100)	85.3	85.4	0.1

Real Pula Exchange Rate Indices[1] (Sept. 2006 = 100)			
Currency	2014 (December)	2015 (December)	Change (Percent)
SA rand	109.7	122.2	11.4
US dollar	103.3	89.5	-13.3
British pound	115.8	105.9	-8.5
Japanese yen	117.8	103.2	-12.3
Euro	109.3	105.9	-3.1
SDR	106.1	96.3	-9.2
REER	106.8	107.2	0.4

1. All real indices calculated using headline inflation.

Source: Bank of Botswana

Chart 1.7: Quarterly Balance of Payments 2014 - 2015



Source: Bank of Botswana

payments does not fully match the monthly trade statistics prepared by Statistics Botswana. For some exports, the trade statistics are supplemented by additional information collected directly from exporters.

thus establishing a substantial re-export trade for rough diamonds in the country.[25] This also benefited local diamond cutting and polishing businesses (Table 1.7), while the decline of the United Kingdom as a major export destination[26] was matched by the growing importance of trade with other global diamond processing centres such as Belgium, India and Israel (Table 1.8).

3.6 However, in 2015 trade in rough and polished diamonds slowed due to decreased demand in global markets, hence lower exports, (both in value and volumes); as a result, diamond exports fell by 19.4 percent to P52.7 billion (Table 1.9). The decline in exports was aggravated by lower sales of copper and nickel, which decreased by 15.4 percent to P3.7 billion; exports of gold also declined by 21.6 percent to P283 million. Overall, despite some growth in exports of beef, vehicles and other goods, total exports fell by 16.9 percent, with the result that the merchandise trade deficit was P8.3 billion in 2015, compared to a surplus of P4.7 billion in 2014.

3.7 Imports for 2015 are estimated at P71.8 billion, which is an increase of 0.1 percent from the revised P71.7 billion in 2014 (Table 1.10). Imports of diamonds (rough and polished) declined by 7.1 percent as a result of low global demand for their subsequent re-export. Fuel imports also fell by 16.4 percent and benefiting from lower global oil prices, rather than a decline in volume. However, the overall decline in imports was moderated by growth in imports of food, machinery and electrical equipment and chemicals and rubber products by 11.7 percent, 11.5 percent and 8.3 percent, respectively.

25 In addition to Botswana, De Beers Global Sightholder Services (DBGSS) processes rough diamonds from other countries where De Beers has mining operations: that is Canada, Namibia and South Africa. The aggregation and sales processes add value to the imported rough diamonds, which is reflected in the trade balance. Some aspects of the statistical treatment of diamond trade flows continue to be reviewed and, as such, may be subject to further revision.

26 De Beers' aggregation and sales functions were previously carried out in the UK.

TABLE 1.6: BALANCE OF PAYMENTS 2011-2015 (P MILLION)

	2011*	2012*	2013*	2014#	2015#
Current Account	3 250	-1 274	11 624	22 240	11 314
Of which:					
Merchandise Trade	-4 779	-16 713	-2 353	4 693	-8 264
Services	952	1 836	2 974	5 187	6 332
Income	-768	331	-3 152	-3 102	-3 013
Net Current Transfers	7 846	13 272	14 156	15 463	16 260
Financial Account	7 008	1 523	-8 101	2 658	-8 590
Capital Account	3	-	1	-	-
Net Errors and Omissions	-6 831	- 1 112	-2 184	-13 494	-2 782
Overall Balance	3 430	-862	1 340	11 404	-57

* Revised
\# Provisional
Source: Bank of Botswana

TABLE 1.7: DIAMOND TRADE 2015 (P MILLION)

		Exports					
		Rough					
Period		Botswana Exports (1)	Total Exports (2)	Polished Exports (3)	Total (Rough and Polished) (4) = (2) + (3)	Imports (5)	Net Re-Exports (6) = ((2) – (1)) – (5)
2013		28 469	48 693	6 674	55 367	24 507	-4 282
2014		35 512	57 952	7 375	65 327	25 980	-3 539
2015	**Q1**	9 483	15 271	1 192	16 463	6 619	-831
	Q2	8 361	15 360	1 258	16 618	7 920	-921
	Q3	6 767	8 486	1 123	9 609	6 013	-4 293
	Q4	1 198	9 094	871	9 965	3 593	4 303
Total		25 809	48 211	4 444	52 655	24 145	-1 743

1. **Botswana Exports:** Refers to the value of rough diamonds mined in Botswana and sold abroad. These are important for balance of payments purposes, as such exports are accompanied by financial inflows reported in the financial account.
2. **Total Exports:** Represents the value of rough diamonds from Botswana, including re-exports. Subtracting Botswana diamonds from this total approximates the gross value of re-exports. However, this is subject to distortions due to time lags, which mean that the two sets of data are not fully comparable, especially over short time periods.
3. **Net Re-Exports of Rough Diamonds**: This is important for balance of payments purposes and is approximated by subtracting the value of imports from the gross value of re-exports. It is subject to similar limitation as the gross measure.

Source: Bank of Botswana

Services[27]

3.8 In 2015, the services account recorded a surplus of P6.3 billion, compared to the revised surplus of P5.2 billion in the previous year (Chart 1.8). Total exports of services, at P12.7 billion, were 4.6 percent higher than the previous year. *Transportation* and *travel* (mainly tourism receipts), increased by 18.4 percent and 9.5 percent respectively, while export of *other services de*creased by 12.1 percent.[28] Imports of services declined by 8.4 percent to P6.4 billion, due to lower imports of *transportation*

27 Data on services should be interpreted with caution due to challenges relating to data collection.

28 Estimates for this category now incorporate additional information on tourist-related expenditures prepared by the Department of Tourism.

Table 1.8: Total Exports by Destination in 2011 - 2015 (Percent) [1]

	2011	2012	2013	2014	2015
United Kingdom	62.4	60.4	31.0	0.9	0.9
Belgium	2.7	4.3	12.0	23.6	19.7
Namibia	0.5	1.9	11.7	9.8	11.0
United Arab Emirates	0.2	0.3	1.0	4.3	5.9
Israel	5.2	5.4	5.7	7.7	6.5
India	1.3	1.1	2.7	13.7	13.3
United States of America	1.1	1.2	1.3	2.7	2.6
South Africa	13.6	13.2	15.4	13.4	14.8
Canada	0.0	0.0	6.3	6.5	5.9
Norway	4.8	5.3	4.4	2.6	2.8
Other	13.0	12.2	12.9	17.4	19.3
Total	**100**	**100**	**100**	**100**	**100**

1. Countries for which exports of diamonds are particularly important are highlighted.

Source: Bank of Botswana

Table 1.9: Exports 2014 – 2015 (P Million)

			Percent		Percentage
	2014	2015	2014	2015	Change
Total Exports	**76 417**	**63 528**			**-16.9**
of which:					
Diamonds	65 327	52 656	85.5	82.9	-19.4
Copper-Nickel	4 392	3 716	5.7	5.8	-15.4
Beef	1 002	1 057	1.3	1.7	5.4
Soda Ash	862	924	1.1	1.5	7.3
Gold	361	283	0.5	0.4	-21.6
Textile	376	373	0.5	0.6	-0.7
Vehicles	600	701	0.8	1.1	16.8
Other Goods	3 497	3 819	4.6	6.0	9.2

Source: Bank of Botswana

and travel (travel abroad by locals), which fell by 47.2 percent and 1.4 percent, respectively.

Income Account

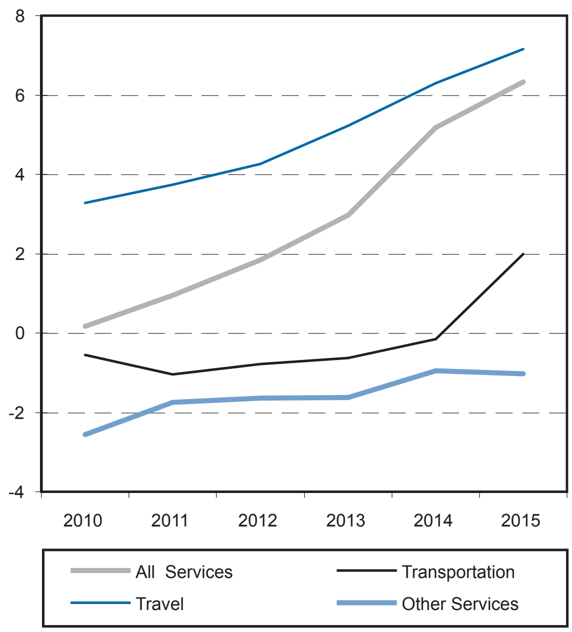
3.9 The income account registered a deficit of P3 billion in 2015, which is slightly lower than the revised deficit of P3.1 billion in 2014. The credit side of this account comprises mainly earnings from foreign exchange reserves which increased by 13.3 percent to P1.9 billion. The debit component consists of dividends and retained earnings[29] of foreign companies operating in Botswana and interest payments on external debt, which decreased from P4.8 billion in 2014 to P4.7 billion in 2015.

Current Transfers

3.10 Net current transfers continue to rise, mainly due to both SACU receipts and private transfers. These increased from a surplus of P15.5 billion in 2014 to P16.3 billion in 2015, with net Government transfers growing by 3.5 percent to P15.8 billion. Net private transfers registered a surplus of P451 million, compared to P188 million in 2014.

29 Retained earnings by foreign-owned businesses are treated as an imputed outflow on the income account, matched by an offsetting inflow for foreign direct investment.

Chart 1.8: Balance of Trade in Services (2010 - 2015)



Source: Bank of Botswana

Table 1.10: Imports 2014 – 2015 (P Million)

	2014	2015	Percent 2014	Percent 2015	Percentage Change
Total Imports	**71 724**	**71 792**			**0.1**
of which:					
Diamonds	25 980	24 145	36.2	33.6	-7.1
Fuel	10 894	9 103	15.2	12.7	-16.4
Food	6 286	7 020	8.8	9.8	11.7
Machinery & Electrical Equipment	8 251	9 196	11.5	12.8	11.5
Chemicals & Rubber Products	5 870	6 358	8.2	8.9	8.3
Metals & Metal Products	2 802	2 904	3.9	4.0	3.7
Textile & Footwear	2 047	2 171	2.9	3.0	6.1
Vehicles & Transport Equipment	5 616	5 313	7.8	7.4	-5.4
Other	3 980	5 583	5.5	7.8	40.3

Source: Bank of Botswana

Capital and Financial Accounts

3.11 The capital account records transfers of financial assets by migrants to and from Botswana and, as in previous years, such transfers were insignificant in 2015.

3.12 The financial account, which is made up of direct investment, portfolio investment and "other" investment,[30] registered a net outflow of P8.6 billion in 2015 compared to the revised net inflow of P2.7 billion in 2014.[31] This reflects increased holdings of offshore assets by pension funds and external deposits by commercial banks.

Foreign Exchange Reserves

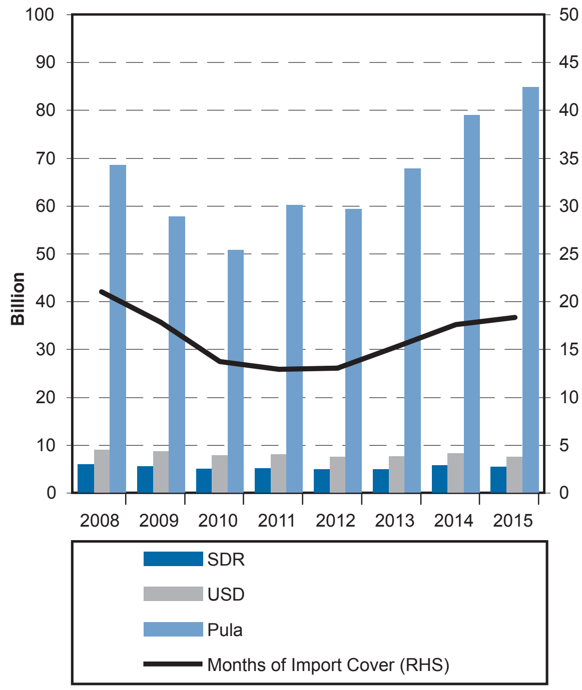
3.13 The foreign exchange reserves increased by 7.3 percent from P79.1 billion in December 2014 to P84.9 billion in December 2015 (Chart 1.9). This was equivalent to 18.3 months of import cover[32] in December 2015, compared to 17.6 months the previous year. The increase in reserves reflects market and currency valuation gains, despite net outflows arising from the overall balance of payments deficit. The currency valuation gains resulted from the depreciation of the Pula against currencies in which the reserves are held. In foreign currency

30 Other investment comprises borrowing from and lending to foreign entities not classified as direct investment and portfolio investment.

31 The 2015 position is based on preliminary estimates and is subject to revision following completion of the 2015 Balance of Payments Survey.

32 The calculation of import cover excludes imports of rough diamonds, as these are mainly for re-export.

Chart 1.9: Level of Foreign Exchange Reserves



Source: Bank of Botswana

terms, the level of reserves declined by 9.3 percent to USD7.5 billion and by 5.3 percent to SDR5.4 billion.

(c) Balance of Payments Outlook

3.14 Although a gradual recovery can be expected in the medium term, the downward pressure on the current account seen in the second half of 2015 is likely to continue in the short term. Volumes of rough diamond sales will continue to be constrained by weak global demand and further price reductions are also possible. At the same time, some slowdown in receipts from SACU is also anticipated, following several years of buoyant growth. Imports are expected to increase to support growth in other sectors of the economy, and may be boosted by government expenditure. Inflows on the financial account will, to a large extent, finance private sector investment.

(d) International Investment Position (IIP) and Foreign Investment

3.15 Detailed estimates for the IIP, which records the stock of foreign assets and liabilities, are only available up to 2014. For 2015, only preliminary estimates for the major aggregate are available.

(i) International Investment Position[33]

3.16 Preliminary estimates for 2015 indicate that Botswana's net international investment was P67.4 billion, which was 21.8 percent higher than P55.3 billion in 2014. This was driven by an increase of 12.9 percent in foreign assets from P133.7 billion in 2014 to P150.9 billion; foreign liabilities rose by 6.7 percent from P78.3 billion to P83.6 billion in the same period. On the asset side, the stock of 'direct investment', 'portfolio investment', 'other investment' and 'reserve assets' increased by 10.7 percent, 24.5 percent, 18.1 percent and 7.3 percent, respectively. Reserve assets, which rose by 7.3 percent to P84.9 billion in 2015, continue to make a significant positive contribution to the total stock of foreign assets. On the liabilities side, 'direct investment' increased by 8.1 percent from P49.5 billion in 2014 to P53.5 billion in 2015, 'portfolio investment' was unchanged and 'other investment' increased by 4.8 percent from P26 billion to P27.3 billion.

(ii) Investment in Botswana by Industry and Country Classification in 2014

3.17 Tables 1.11 and 1.12 [34] show the stock of Botswana's foreign liabilities at the end of 2014, classified by industry and country, respectively. The mining and finance sectors have the largest shares of foreign direct investment at 44.6 percent and 35.7 percent, respectively. Africa is the major source of direct investment in Botswana accounting for 49.9 percent, of which investment from South Africa makes up 32.6 percent, followed by Europe with 43.5 percent. The bulk of direct investment from Europe is from Luxembourg (with 27.9 percent) due to the residence status of the major mining investors in Botswana.

33 There have been revisions to the data to align it with balance of payments flows.

34 These figures are based on the 2014 Balance of Payments Survey conducted by the Bank of Botswana.

Table 1.11: Level of Foreign Investment in Botswana by Industry 2014 (P Million)

Industry	Direct Investment	Other Investment	Total
Mining	8 531	6 415	14 945
Manufacturing	466	277	743
Finance	6 832	2 266	9 098
Retail and wholesale	1 143	1 025	2 168
Electricity, gas and water	0	6 602	6 602
Real estate and business services	292	18	310
Transport, storage and communications	155	41	196
Construction	38	0	38
Hospitality	122	26	148
Public administration	0	15 861	15 861
Other	1 552	1 192	2 744
Total	**19 131**	**33 722**	**52 853**

Source: Bank of Botswana

Table 1:12: Levels of Foreign Investment in Botswana by Country 2014 (P Million)

Country	Foreign Direct Investment	Other Investment	Total
North and Central America	277	686	963
Of which			
United States	122	683	805
Europe	8 330	1 298	9 628
Of which			
United Kingdom	1 679	248	1 927
Netherlands	225	0	225
Luxembourg	5 340	549	5 889
Other Europe	1 085	500	1 586
Asia Pacific	281	6 731	7 012
Africa	9 544	4 955	14 499
Of which			
South Africa	6 232	2 307	8 539
Middle East	116	145	260
Other	583	19 907	36 351
Total	**19 131**	**33 722**	**52 853**

Source: Bank of Botswana

3.18 In 2014, government external debt, classified under ‘public administration’ constituted 47 percent of ‘other investment’ by foreigners. This was followed by electricity, gas and water (dominated by debt financing, sourced from China, for the Morupule B power plant), and mining with respective shares of 19.6 and 19 percent. By country, the largest share of ‘other investment’ was for the ‘other’ category with 59 percent, which includes public borrowing from multilateral development partners, such as the African Development Bank (AfDB) and the World Bank, followed by Asia-Pacific (20 percent) and South Africa (6.8 percent).

4. Money and Capital Markets

(a) Monetary Policy

4.1 The primary objective of the Bank’s monetary policy is to achieve price stability, which is defined as a sustainable level of inflation that is within the medium-term objective range of 3 – 6 percent. The policy is also formulated with a view to safeguarding the stability of the financial system. A low and predictable level of inflation and a conducive financial environment foster savings mobilisation, productive investment and international competitiveness of domestic producers which, in turn, contribute towards the broader national objective of sustainable economic development.

4.2 The monetary policy framework is based on a forecast, with a medium-term outlook that primarily guides the Bank's response to projected movements in inflation, while taking account of prospects for economic growth and developments relating to stability of the financial system. To this end, in assessing the policy stance, the Bank factors in projections of real monetary conditions[35] in the context of other relevant domestic and international economic and financial developments, and their impact on the output gap[36] and, ultimately, inflation. The policy framework also recognises the importance of communication with stakeholders in order to influence expectations. Accordingly, the Bank issues a press release after the meetings of the Monetary Policy Committee to announce policy decisions and their rationale.

(b) Interest Rates and Bank of Botswana Certificates

4.3 In 2015, monetary policy was conducted in an environment of slow growth in global economic activity, benign inflationary pressures and lower commodity prices, particularly for oil. Below-trend domestic economic growth indicated a non-inflationary output gap, which alongside modest domestic demand and subdued external price pressures contributed to the positive inflation outlook in the medium term. Thus, an accommodative monetary policy stance was adopted to support economic activity, with the Bank Rate reduced by a cumulative 150 basis points from 7.5 percent to 6 percent in the course of the year. As a result, the prime lending rate of commercial banks decreased from 9 percent to 7.5 percent. The yield on the 14-day Bank of Botswana Certificates (BoBCs) decreased from 3.07 percent in December 2014 to 0.97 percent in December 2015, while the 3-month BoBC yield declined from 3.19 percent to 1.17 percent.[37]

4.4 The real 3-month BoBC yield decreased from -0.59 percent to -1.87 percent, thus reflecting the bigger decrease in the nominal interest rate compared to that of inflation between December 2014 and December 2015. The real 14-day BoBC rate decreased from -0.7 percent in December 2014 to -2.07 percent in December 2015.

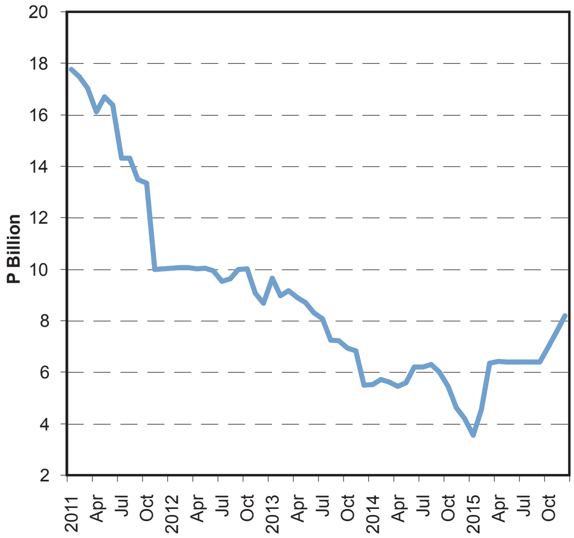
4.5 Implementation of monetary policy entailed open market operations, with excess liquidity absorbed through the sale of BoBCs to achieve interest rates consistent with the policy stance. Temporary liquidity shortfalls experienced by individual banks at the beginning of the year (which, to some extent, reflected inefficiency of the interbank market and volatility of bulky corporate/fund manager deposits) continued to be addressed through recourse to the Bank's credit facilities. In addition, the primary reserve requirement (PRR) for Pula-denominated deposits was reduced from 10 percent to 5 percent effective April 1, 2015; this adjustment of the PRR injected about P2.3 billion into the banking system. Given a higher level of excess liquidity, the value of outstanding BoBCs was P8.2 billion in December 2015, up from P4.2 billion in December 2014 (Chart 1.10). Reverse repurchase agreements (reverse repos) were used to manage intra-auction liquidity. In December 2015, the amount of excess liquidity absorbed through reverse repos was P1.7 billion, compared to P304 million in December 2014.

35 The real monetary conditions index (RMCI) measures the relative looseness or tightness of monetary conditions and gauges the likely effect that monetary policy has on the economy through changes in the exchange rate and interest rates. The real monetary conditions are measured by the RMCI that combines, through a weighted average, the deviations of the real exchange rate and real interest rate from their respective trend values.

36 The output gap refers to the difference between actual output and long-term trend output (as an indicator of productive capacity). A negative output gap means the actual level of output for a given period is below the trend level for that period, thus indicating the economy is operating below its estimated potential.

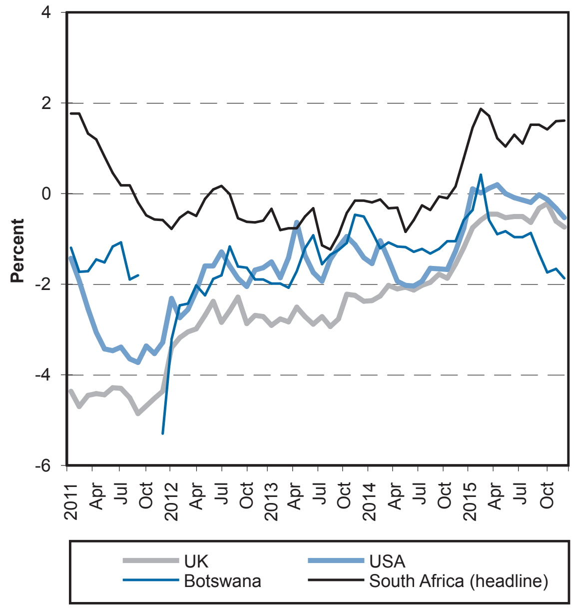
37 The quoted yields for both the 14-day and 91-day maturities are a weighted average of winning bids' yields at auction.

Chart 1.10: Outstanding Bank of Botswana Certificates



Source: Bank of Botswana

Chart 1.11: Real Interest Rates - International Comparisons



Note: There was no auction for the 3-month BoBC in November 2011.

Source: Bank of Botswana

(c) Banking System

Domestic Credit

4.6 Annual growth in commercial bank credit eased from 13.5 percent in 2014 to 7.1 percent in 2015 due to a decline in growth of lending to the business sector from 17.2 percent to -0.3 percent. In contrast, growth in household credit increased from 10.7 percent to 12.8 percent in the same period (Chart 1.12). As at December 2015, the share of household credit in total private commercial bank credit was 59.4 percent compared to 56.4 percent in December 2014.

4.7 Annual growth in unsecured lending to households increased from 7.4 percent in 2014 to 15.5 percent in 2015 while growth in mortgage lending declined from 18.4 percent to 7.2 percent. Developments with respect to household credit are in line with the slower growth in incomes and augur well for maintenance of financial stability. In particular, the moderation in mortgage credit growth against the background of the weaker property market reduces potential risks in this area. Thus, the prevailing low and stable default ratios for household borrowing[38] and sufficient provisioning by banks, alongside capital, asset quality, liquidity and profitability levels that meet prudential requirements for banks, underpin a stable financial system. Moreover, the favourable prospects for sustained positive economic performance imply potential growth in incomes and demand to support a sound financial system.

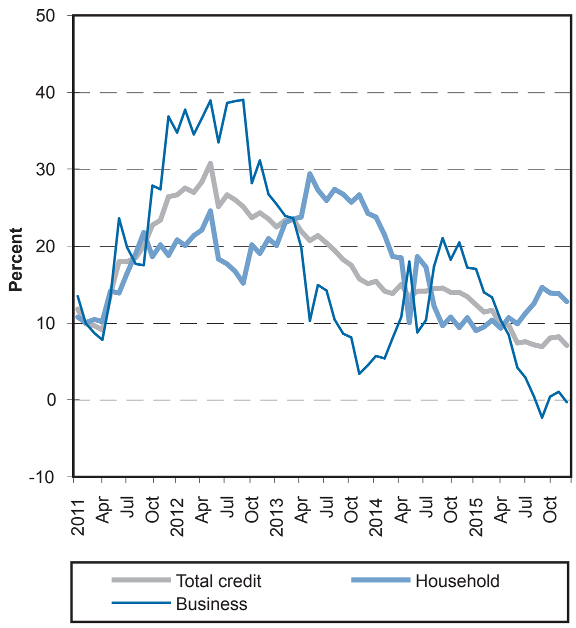
4.8 Growth in commercial bank credit to households continues to be monitored for potential impact on demand and financial stability. Overall, banking system indicators, including low default ratios for household borrowing, point to a stable financial environment. Household loans, at 59.4 percent share of credit as at the end of December 2015, continue to dominate commercial bank credit. The concentration of household credit in unsecured lending (65.8 percent) remains a concern, including the degree of productivity of such lending. However, the risk to financial stability is moderated by the extent to which such credit is diversified and potentially contributes to an increase in wealth.[39] Furthermore, the bulk of household credit is to salaried individuals,

38 The aggregate ratio of non-performing loans to total credit was 3.3 percent at the end of December 2015, but with a range of zero to 8.4 percent for individual banks.

39 There can be wealth gains if such borrowing is used to acquire, construct or improve property that subsequently increases in value.

P Billion

Chart 1.12: Year-on-Year Commercial Bank Credit Growth



Source: Bank of Botswana

which allows for proper credit evaluation using proven wage income as the basis for determining ability to pay. Where the risk of loss of employment is low and the loan is protected by credit life insurance, credit risk can be low. Business credit is also diversified across economic sectors.

Monetary Aggregates

4.9 Annual growth in broad money supply increased from 4.6 percent in December 2014 to 19.9 percent in December 2015. The accelerated pace of growth reflected the impact of the expansion in credit and the increase in net foreign assets, as well as the decline in government deposits at the Bank of Botswana. By component, currency outside depository corporations and other deposits grew annually by 0.3 percent and 24.8 percent, respectively, in December 2015. Meanwhile, transferable deposits (i.e., current accounts) grew by 4.6 percent in the same period. The Pula value of deposits in foreign currency accounts (FCAs) increased by 16.4 percent in the twelve months to December 2015 and accounted for 15.5 percent of total deposits at commercial banks.

Bank of Botswana

4.10 Total assets and liabilities of the Bank of Botswana grew by 7.2 percent, from P79.7 billion in December 2014 to P85.4 billion in December 2015. The expansion in the balance sheet in 2015 reflected the impact of the 7.3 percent increase in the foreign exchange reserves. Shareholder's funds, which largely comprise the Government's share of the Pula Fund and Liquidity Portfolio, increased by 3.4 percent from P63.8 billion to P66 billion. The Government investment account stood at P35.5 billion in December 2015, a decrease of 4.7 percent from P37.3 billion in December 2014. Commercial bank deposits at the Bank of Botswana (including primary reserve requirement balances) declined from P4.5 billion to P3 billion, largely reflecting the reduction in the reserve requirement ratio in April 2015. The value of outstanding BoBCs rose by 94.9 percent in 2015 from P4.2 billion to P8.2 billion due to an increase in excess liquidity, which resulted from a reduction in primary reserve requirements (intended to address tight liquidity earlier in 2015) and growth in deposits at commercial banks. Among others, the increase in deposits was due to a significant placement by the Botswana Public Officers Pension Fund and expansion in government spending, including lending to parastatals.

Commercial Banks

4.11 Total banking sector assets amounted to P76.7 billion in December 2015, an increase of 12.8 percent from P68 billion in December 2014. This growth was attributable to an increase of 6.5 percent in loans and advances from P44.1 billion to P47 billion, along with growth of 91.9 percent in BoBCs held by banks. Similarly, year-on-year to December 2015, domestic banks' deposits held in foreign banks grew by 26.8 percent, while "other assets" expanded by 21.6 percent. On the liabilities side, deposits at commercial banks increased by 16.3 percent in the same period. A continuing feature of commercial banks' balance sheets is that funding is supported by wholesale business deposits (71.3 percent of total deposits in December

2015), which sustains the net debtor position of households in relation to banks. The ratio of commercial bank assets to nominal GDP remained relatively stable at around 50 percent in both 2014 and 2015, while the credit to GDP ratio was 31.7 percent in the same period.

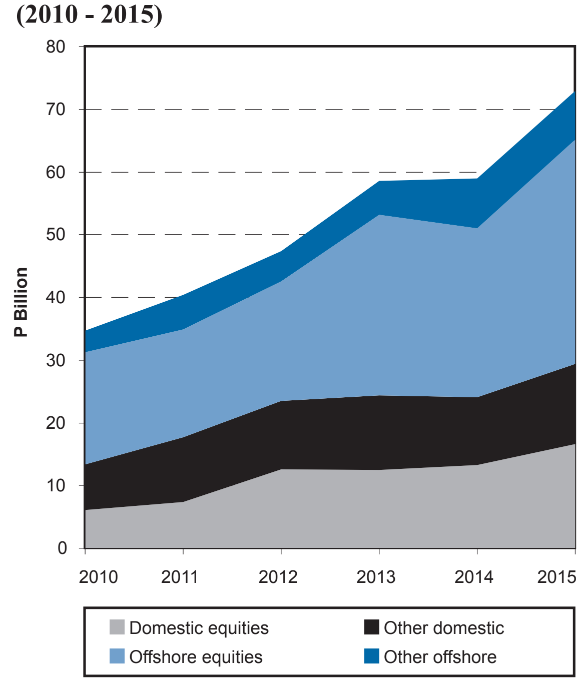
(d) Other Financial Institutions

4.12 The balance sheet of the Botswana Building Society grew by 24.6 percent in 2015 (12.4 percent in 2014) from P3.4 billion in December 2014 to P4.3 billion in December 2015. Loans and advances increased by 7.2 percent, while the Society's cash and deposits rose by 164.6 percent in the same period. These were financed by the year-on-year increase of 99.6 percent in customer deposits. Meanwhile, capital and reserves contracted by 27.9 percent from P1.5 billion in December 2014 to P1.1 billion in December 2015. Total assets and liabilities of the National Development Bank contracted by 21.2 percent from P1.9 billion in December 2014 to P1.5 billion in December 2015, reflecting the decline of 19.2 percent in lending in 2015 compared to the increase of 16.1 percent in the previous year.[40] For Botswana Savings Bank, the balance sheet increased by 25.1 percent year-on-year to December 2015 (9.7 percent in 2014) as lending expanded by 28.9 percent (20.3 percent in 2014). Mobilisation of savings was also sustained, with deposits growing by 14.8 percent in 2015, higher than the growth of 10.8 percent in 2014. With respect to Botswana Development Corporation, assets increased by 10.7 percent to P2.3 billion in the twelve months to December 2015, from P2.1 billion in 2014; thus reflecting growth of 11.1 percent in investments in related companies, which offset the decline in loans, advances and leasing.

4.13 The Domestic Companies Index of the Botswana Stock Exchange (BSE) increased by 11.5 percent in 2015 to 10 602.3; this compares to the growth of 5.4 percent in 2014. Trading was active, with 834.1 million shares valued at P3 billion traded during the year, compared to 602 million shares valued at P2.2 billion in 2014. The market capitalisation of domestic companies grew by 8.2 percent from P46.2 billion in December 2014 to P50 billion in December 2015 due to the significant increase in the share prices of most of the listed companies in 2015. However, the number of listed domestic companies in 2015 fell from 24 at the end of 2014 to 22 in December 2015 as a result of the delisting of African Banking Corporation Holdings Limited and FSG Limited from the stock exchange. The Foreign Companies Index (FCI) declined by 0.4 percent in 2015, ending the year at 1 572.4, following a contraction of 0.3 percent in 2014. Ten companies were listed on Foreign Companies board at the end of 2015, down from 12 in 2014.

4.14 Pension funds' assets increased by 21 percent, from P59.4 billion in December 2014 to P71.9 billion in September 2015 (Chart 1.13). By class of asset holdings, domestic equities grew by 24.8 percent to P16.6 billion in the same period, while offshore equities increased by 33.1 percent to P35.8 billion. Meanwhile, the value of domestic bonds held by pension funds fell

CHART 1.13: BOTSWANA PENSION FUND ASSETS (2010 - 2015)



Source: NBFIRA

40 The contraction in lending reflected an increase in provisions for loan losses, which increased by 80.2 percent, from P211 million in 2014 to P381 million in 2015, and indicating a deterioration in the quality of the bank's loan book.

by 24.5 percent to P5.9 billion, while offshore bonds increased by 24.2 percent to P7.5 billion. The proportion of assets invested offshore by pension funds increased from 58.8 percent in December 2014 to 60.5 percent in September 2015.

4.15 The Government remains supportive of capital market development through issuing securities under the P15 billion Bond Note Programme. In 2015, several bonds (of 2.5 years, 6 years, and 17 years maturity) were re-opened, while four rollovers of the 6 months Treasury Bills were conducted. As at December 2015, the total par value of outstanding bonds and Treasury Bills was P7.2 billion (the same as in 2014), with 24.3 percent and 75.4 percent held by primary dealers (banks) and their clients, respectively. The Bank of Botswana held the balance of P20 million (0.3 percent) for potential secondary market activity.

(e) Credit Rating

4.16 Both the international sovereign credit rating agencies, Moody's Investors Service (Moody's) and Standard & Poor's (S & P), maintained the investment grade sovereign credit ratings for Botswana of A2 and A-/A-2 (short/long term), respectively, and the stable outlook. The ratings are supported by the strong external and fiscal balance sheets, net external creditor position and low public debt. The agencies recognised the country's continued political stability, presence of strong institutional frameworks, which resulted in prudent policy making. While the risk of a ratings downgrade remains low, there continues to be concern about the narrow economic base and relatively slow progress in economic diversification.

Chapter 2

Employment Opportunities, Productivity and Competitiveness as Contributors to Sustainable Economic Growth: Botswana's Case

1. Introduction

1.1 The Botswana economy has performed well by most economic and developmental criteria since independence in 1966. Annual growth averaged 6.4 percent in real terms between 1981 and 2014, resulting in a near seven-fold expansion of the economy, underpinned by sustained macroeconomic stability. In turn, this translated into higher living standards across the population, as indicated by a significant reduction in the incidence of poverty, rising household incomes, improved provision of social services and public infrastructure. Moreover, prudent macroeconomic management has meant that this record of strong economic growth has been accompanied by the build-up of significant financial reserves, enabling the country to weather major economic shocks and make provision for future generations at the time when the diamond resource is depleted.

1.2 The major blight on this otherwise impressive track record is unemployment. The economy is still dominated by capital-intensive mining and job creation has not matched the pace of economic expansion and growth in the labour force. Unemployment is estimated at 20 percent of the active labour force, while for many, and although not technically counted as unemployed, employment is in the form of low income informal/subsistence and often part-time activities. Looking ahead, providing enough jobs will become more challenging in the context of modest rates of economic growth compared to the past. Like many countries in Africa, the increase in the number of younger, better-educated generations has the potential to become a "demographic dividend"; however, on current trends, this threatens to be a "demographic time bomb" if chronic youth unemployment is not addressed.

1.3 Unemployment imposes a variety of costs on society as a major cause of poverty, crime, ill-health and social unrest. Conversely, reducing unemployment through creating sustainable job opportunities supports inclusive growth, rising living standards and social stability. As a result of persistent unemployment, poverty and inequality remain widespread at levels unacceptable for a country in Botswana's position, with aspirations to become a high-income economy. There is, therefore, a need to rethink the development strategies with a view to spreading the benefits of economic growth widely.

1.4 Unemployment is the result of varied and complex sources. Slow progress in diversifying Botswana's economy potentially limits the availability of job opportunities, and this can be aggravated by lower rates of growth. However, persistent unemployment at such high levels that compare unfavourably with most comparator countries suggests that structural factors are also involved. Notably, skills gaps can result in low productivity, with a negative impact on business viability or even failure to take up available opportunities. Related to skills are also issues of motivation and readiness for employment or self-employment.

1.5 As fundamental to economic growth and diversification, it is necessary to identify the relevant indicators of productivity and competitiveness and how these relate to important facets of growth, innovation and access to markets that would support economic diversification. Comparison of Botswana with more successful countries with respect to competitiveness and productivity could provide lessons in terms of relevant policy interventions at the macro and micro levels.

1.6 A country's performance in global rankings of productivity and competitiveness is a reflection of government policies, effectiveness of institutions, the regulatory environment and capacity to implement projects and programmes. Over the years, Botswana has undertaken measures to address impediments in this regard, and progress has to be examined, taking into account instances where government intervention may have only a limited impact.

1.7 As critical inputs to production, infrastructure and effective delivery of utilities are also vital for productivity and competitiveness. Country comparisons in relation to access to, among others, electricity, water, transport, information and communications technology help ascertain if these are indeed a constraint. Apart from the direct provision of infrastructure and services by government and/or state-owned enterprises, there are issues of pricing, the role of the private sector and regional cooperation and integration that are also relevant.

1.8 There is a perennial argument in Botswana that the education system does not produce skills required for productive employment. Reasons for this could include deficient/inappropriate curricula, weak instruction and lacklustre quality control and enforcement of standards. However, industry also has a role to play in preparing new entrants for the job market, and adopting management practices that encourage high productivity. An overview and assessment of the education system, supervisory environment, industrial relations and industry participation could thus illuminate the relevant issues.

1.9 To address these issues, Section 2 looks first at the concepts of unemployment, productivity and competitiveness, including how they are measured in practice and highlighting interlinkages. This is followed by Section 3 which examines the long-term historical trends in unemployment and productivity in Botswana. The role of government in promoting employment, productivity and competitiveness is considered in the next two sections, looking first at the role of policies and institutions in Section 4 and then, in Section 5, the provision of infrastructure and utilities. Finally, before concluding, Section 6 examines challenges arising from the labour market and skills development.

2. Fundamentals of Productivity and Competitiveness, and Their Impact on Unemployment and Job Creation

2.1 This Section outlines the basic analytical framework used in addressing unemployment, productivity and competitiveness. This includes definitions, measures and related indicators, and the key inter-relationships so as to shed light on the critical choices faced by policymakers to achieve development that encompasses economic growth, rising living standards and full employment.

(a) Unemployment

2.2 The International Labour Organisation (ILO) defines unemployment (U) as members of the labour force (LF) who are without paid employment or self-employment, but who are willing, able, available and actively looking for such employment.[1] Taking E as representing employed persons, u the unemployment rate and $LFPR$ as the Labour Force Participation Rate or the proportion of economically active people of working age (W), unemployment is defined as:[2]

$$U = LFPR \text{ x } W - E \qquad (1)$$

Equation 1 implies that unemployment may fall not only through job creation, but also due to a decline in the $LFPR$, including an increase in discouraged job seekers.

2.3 Figure 1 provides a schematic overview of this basic framework, from which measures of unemployment and labour force participation can also be calculated for sub-groups within the labour force, including by age, gender, level of education, profession, previous occupation and geographical location. However, there are

1 Adopted by the Thirteenth International Conference of Labour Statisticians (Geneva, 1982).

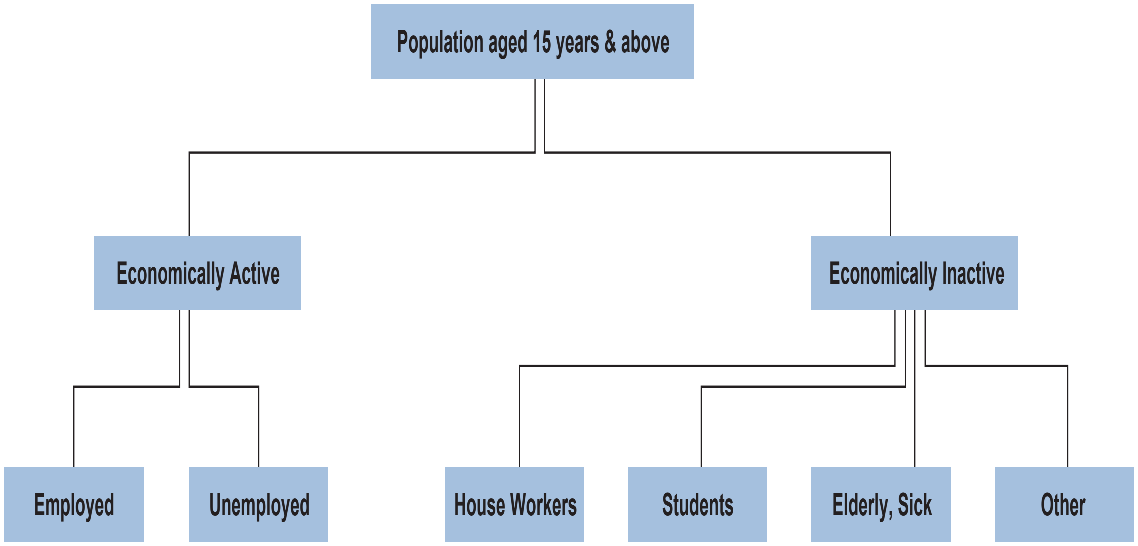
2 Equation 1 is derived from a combination of the following equations;

$$u = U/LF = (LF - E)/LF$$

$$\text{where, } LF = E + U \qquad (a)$$

$$LFPR = LF/W \quad \text{or} \quad LF = LFPR \text{ x } W \qquad (b)$$

FIGURE 3: POPULATION AGED 15 YEARS AND ABOVE



Source: Statistics Botswana, Population & Housing Census 2011

several conceptual, practical and measurement difficulties associated with these measures. As a result, measures of unemployment used in practice may vary considerably from country to country, or over time within any given country.

2.4 The major disagreement is over the criterion that people must be actively looking for work to count as being unemployed and, in particular, where the lack of job opportunities has discouraged them from looking for work. In effect, there are suggestions that excluding "discouraged workers" from official statistics may significantly understate the "true" level of unemployment. For this reason, some countries, including Botswana, have also produced alternative measures of unemployment where the working age population who are discouraged from seeking work are included. Also, in some countries, the distinction between being able to work and actively looking to do so has been dropped entirely.[3]

2.5 Other key issues include the meaning of "working age", being "without work", "economically inactive" and "actively looking for work":

(i) *Working age*: the standard definition of the working age population (i.e., those who are potentially economically active) is those aged between 15 and 64, with most controversy surrounding the bottom end, due to concerns about child labour.[4] The choice of 15 is in line with the basic minimum working age in the relevant ILO convention.

(ii) *Without work*: the standard practice is to apply a strict meaning to unemployment as the complete absence of work, meaning that even minimal part-time work is counted as employment. This results in a further major criticism of official statistics for not taking proper account of *under*employment.

(iii) *Economically inactive*: by definition, the economically inactive population is the portion of the working age population which is neither employed nor actively

3 In more formal labour market settings, where job-search activities are mainly through a range of established channels, it may be relatively easy to identify those who are actively looking for work. However, in developing economies, the labour market is largely not organised and self-and/or informal employment are more prevalent. This may be more challenging to the extent that the ILO recognises that the distinction between those who are able and those who are willing to work can be dropped in practice. In such cases, the working age population and the labour force are treated as equivalent.

4 The upper limit of 64 is less contentious, in line with the standard retirement age in many countries; however, this could be subject to review given longer life expectancy and the resultant growth in those over 64 who remain economically active.

seeking work and these include students, full-time homemakers or those engaged in various "non-economic" activities. Work (paid or otherwise) that may be more properly regarded as part of social welfare programmes (for example, the *Ipelegeng* programme in Botswana) could be included in this category.[5]

2.6 Regarding measurement of unemployment, two major data sources, namely, labour force surveys and management data are used, often in conjunction. Management data is sourced from the records of either employment bureaus or social welfare programmes related to unemployment. However, this is often lacking for developing economies as they generally do not have the necessary formal labour market and related institutions. On the other hand, surveys are infrequent because of resource intensity and costs involved.

2.7 Analytically, different types of unemployment have been identified, so as to break down total unemployment by its major causes. These include:

(i) *frictional unemployment* which, represents the natural "churn" (including through job search activities) in the labour market as workers move between jobs, and is indicative of a dynamic, developing economy;

(ii) *cyclical unemployment* arises when there is insufficient demand in the economy to provide jobs for everyone who is willing to work;

(iii) *structural unemployment* where unemployment remains chronically high in the face of economic growth, due either to the growth not generating sufficient job opportunities, or unwillingness/inability of workers to take advantage of available opportunities;

(iv) *voluntary unemployment* occurs in situations where jobs may be available, but prevailing wages are below the level at which the unemployed are prepared to work (the so-called reservation wage).

5 Production for own use, including subsistence agriculture, may also be treated as a non-economic activity. However, this is not the case in Botswana where such activities are regarded as employment.

(b) Productivity[6]

2.8 The most basic measure of productivity is labour productivity (P_L): that is, output (Y) divided by the total input of labour (L), i.e.:

$$P_L = Y/L \quad or \; Y = L \, x \, P_L \qquad (2)$$

Similar relationships can be used to calculate productivity of other inputs, notably capital (K).

2.9 This simple formulation demonstrates the fundamental point that an increase in output results from either more of an input or greater productivity from that input. Thus fundamentally, productivity is higher if there is more output for the *same* level of input.[7] Another implication is that there is a clear connection between labour productivity and living standards. If Y is the output of the whole economy and L is the total population[8], then labour productivity is the equivalent of per capita income, a standard welfare indicator. Thus, a sustainable increase in living standards can only be achieved through improved labour productivity. From this economy-wide measure, it is also clear that unemployment undermines national productivity.[9]

2.10 Increased labour productivity results from one or more of four distinct sources. Most directly, the quality of labour can be improved, including through skills acquisition and education (known as "human capital" development). Labour productivity may also be boosted by

6 Reference to the 2004 Annual Report, where the theme topic was "Improved Productivity – The Key to Sustained Growth and Higher Living Standards for All".

7 In the context of equation (4), working harder refers to an increase in L rather than PL.

8 Or employed labour is a constant proportion of the total population.

9 The productivity of the unemployed is zero, imposing a deadweight loss on the output of the whole economy. High levels of dependency, which reduce the LFPR, may also have a similar effect. This has the important implication that increased employment, even through low-productivity jobs, will boost average productivity at the national level.

more or better quality of other inputs. Most importantly, technological progress is fundamental to improved labour productivity and, hence, living standards. Furthermore, labour productivity can be enhanced by improving the efficiency with which productive inputs operate together, known as total (or multi) factor productivity (TFP) (Box 2.1 provides a detailed discussion of the calculation and interpretation of TFP measures).

2.11 Several studies have sought to identify the main factors that contribute to higher productivity, and Table 2.1 lists some that may be considered relevant for Botswana. It is particularly noteworthy the extent to which many of the potential drivers of productivity are largely outside the direct influence of business. Indeed, of the eleven factors included in Table 2.1, only "management quality" is predominantly determined by internal business decisions, underscoring the importance of "external economies" in determining productivity. However, the responsibility for realising the potential for such efficiencies in practice lies with businesses.

(c) Competitiveness

2.12 Competitiveness is achieved when the cost of inputs used in production is aligned with their productivity so that the final product can be produced in line with the price and quality prevailing in the market(s) where the product is to be sold. In turn, such "correct" pricing of productive inputs requires that markets for these inputs are sufficiently flexible in terms of both pricing mechanisms and allowing supply of the input to respond to price signals. The labour market, where various restrictions that limit flexibility are often encountered, needs to be examined critically in this respect, and these issues are considered in more detail in the context of Botswana in Section 6. But inflexibility may also be present in the market for other inputs, such as land, where controls on pricing, and/or supply or use are common; or restrictions on access to imported inputs, which may be critical for competiveness, especially when producing for export.

Box 2.1: Calculating and Interpreting Measures of Total Factor Productivity

Measures of TFP are derived from a "growth accounting" framework based on the following standard equation relating output to inputs:

$Y = AL^{\alpha}K^{\beta}$ *or* $y = a + \alpha l + \beta k,$ where lower case letters are natural logarithms

Expressing this "production function" in terms of growth rates data, *Y, L*, and *K* are then used to derive rates of change for *a*, which is the measure of productivity growth through which output growth differs from growth in physical inputs. In turn, once a robust series of values for *a* has been established, this can be compared with other indicators to identify possible explanations for changes in productivity. The simple model can also be extended to cover a wider range of factor inputs, with a common addition being to break down *L* into separate measures of skilled and unskilled labour.

This is potentially a powerful measure of trends in productivity that addresses some of the limitations of single factor measures of productivity by more clearly identifying the sources of output growth. For this reason TFP has been widely used in economic analysis, including for Botswana where low, or even negative values for TFP growth have supported the assertion that productivity growth in the country has declined to very low levels (see Section 4).

Nonetheless, indicators of TFP are difficult to measure and interpret and, as such, must be used with caution. In particular, *a* is not measured directly, but as a residual, with the effect that estimates will be vulnerable to any mis-measurement in the other data categories. This includes not only values of *Y, L* and *K*, all of which can be problematic, but also the weights (α and β) assigned to inputs which are typically derived from simplifying assumptions about the structure of the economy. Therefore, while measures of productivity based on TFP can be indicative, it is important that the results are confirmed through relevant supporting analysis.

Table 2.1: Key Factors That Influence Productivity

Factor	Responsibility	Comment/Relevance to Botswana
Good governance and effective public administration	Government	Arbitrary and inefficient administration, including excessive bureaucracy, is a major hindrance to boosting productivity, diverting resources from production to coping with administrative requirements.
Macroeconomic stability	Government	Macroeconomic instability (for example, in the form of uneven growth or high and volatile inflation) can jeopardise investment by businesses that are essential for productivity improvement.
Human capital development	Government, businesses and individuals	Including both general education and specialised skills relevant for potential areas of employment, together with a capacity to learn new skills, including through on-the-job training. Health is also a key component of human capital.
Work ethic and incentives	Government, businesses and individuals	Human capital development may not be sufficient if workers are insufficiently motivated. Conversely, significant productivity gains are still possible where workers are motivated, even in the absence of major investments in human capital. There may be some external causes, but the problem may also be due to poor workplace environment, including incentives and leadership. This has been regularly identified as a major challenge facing businesses in Botswana.
Management quality	Businesses	None of the productivity drivers can fulfill their potential in the absence of effective management.
Competitive markets	Government	Gaining an advantage over competitors is a major spur for productivity; conversely, insulating business from competition through "protectionist" policies (including excessive dependency on government patronage) can undermine long-term competitiveness. Competitive markets also help ensure that production is efficient and in line with consumer demand.
Economic openness	Government	Economic openness encourages productive efficiency, including as part of global value chains, and allows access to necessary resource inputs, skills, capital and technology. This is particularly relevant for small economies with limited domestic resource bases and small markets where competition may otherwise be limited.
Infrastructure provision	Government and private providers of infrastructure/ utilities	Effective transport and communications infrastructure, together with provision of core utilities are essential for all businesses. As a landlocked country, Botswana is heavily dependent on efficient transport and communications; and where utilities provision is relatively expensive and erratic, businesses face productivity and competitiveness challenges.
Efficient and inclusive financial intermediation	Government and financial institutions	Efficient financial intermediation ensures that resources available for investment are directed to productive use and where they can earn the highest return. Financial inclusion also helps to maximise the range of economic opportunities and promote social cohesion. However, inclusion is not solely (or even mainly) indicated by access to credit, while risks to financial stability must be guarded against.
Innovation and use of appropriate technologies	Government and businesses	Businesses face the challenge of identifying, adapting and, where appropriate, developing relevant technologies. More basic Research and Development (R&D) is a public good for which governments have some responsibility, including not only cutting edge research, but also (of particular importance for developing economies) supporting the adoption of relevant technologies developed elsewhere.
Urbanisation	Government	Cities have been shown to have higher levels of productivity compared to smaller population settlements. However, this can be undermined by constraints on efficient urbanisation arising, in particular, from land allocation and transportation networks.

2.13 Moreover, holding prices artificially low in support of competitiveness may not be effective as it can distort allocation in favour of unproductive activities, while also requiring subsidies that must be financed by increased taxation elsewhere, thus discouraging production in those areas. In terms of measurement, key factors that help influence competitiveness may be monitored directly. For instance, movement in wage rates, adjusted for changes in productivity, can be an indicator of whether a business, a region or a country is becoming more or less competitive.

2.14 Similarly, a critical factor that may impact on the competitiveness of domestic businesses *vis-á-vis* competitors in other countries is the exchange rate. For this reason, even if it is not targeted for policy purposes, movements in the real exchange rate (i.e., nominal exchange rate movements adjusted for changes in the relevant price indices) are widely accepted as a key indicator of national competiveness.[10] Real exchange rate *appreciation* typically signals some loss of competitiveness.

to their competiveness, the two most influential of which are the GCI and the EDB survey conducted by the World Economic Forum and the World Bank, respectively.[12]

2.16 The GCI focuses on a range of indicators broadly in line with the productivity drivers listed in Table 2.1, grouped under three broad categories. These are briefly described in Box 2.2. The EDB looks more specifically at the impact of bureaucratic inefficiencies on business costs, thus providing a guide for a reform agenda for policymakers in terms of streamlining bureaucracy.[13]

Box 2.2: Compilation of the Global Competitiveness Index

Indicators in the GCI are divided into 12 "pillars" under three broad categories as follows:

(a) *Basic requirements*: institutions, infrastructure, macroeconomic environment and health and primary education.

(b) *Efficiency enhancers*: includes higher education and training, goods market efficiency, labour market efficiency, financial market development, technological readiness and market size.

(c) *Innovation and sophistication factors*: business sophistication and innovation.

The level of countries' development is also taken into account to determine the weighting accorded to the three main categories. A country can be: (i) factor driven; (ii) efficiency driven; (iii) innovation driven; or (iv) in transition between (i) and (ii) or (ii) and (iii). Botswana is currently ranked as being in transition between factor and efficiency driven, indicating that its priorities should be developing efficient markets and human capital, with relatively less attention to productivity drivers based on innovation and procuring advanced technologies.

Global Competitiveness Index (GCI) and the Ease of Doing Business (EDB)

2.15 A second approach to measurement is to use proximate indicators: i.e., examining the prevalence of conditions that typically promote or hinder competitiveness. This is the basis for the various rankings of countries[11] according

2.17 Table 2.2 shows the most recent rankings by these two measures for: (a) the top ten globally; (b) the top five for Sub-Saharan Africa (SSA); and (c) five other upper-middle income countries (UMICs) from outside Africa with which Botswana is sometimes compared. Previous rankings from 2009/10 are also shown for these

10 Measurement of real exchange rates in practice is now more complicated due to the increasing prevalence of production that is part of global value chains. This is a challenge for exchange rate measures that have assumed that production predominantly takes place in a single country; this is the subject of the growing research literature on "value added exchange rates".

11 The same approach can be applied to ranking areas within countries or by economic sector rather than for the whole economy.

12 Other widely-used similar measures include the Corruption Perceptions Index and the Index of Economic Freedom prepared by Transparency International and the Heritage Foundation, respectively.

13 The EDB measure does not suggest that all regulation is bad; indeed, some regulation is essential for the smooth functioning of a modern economy. But, at the same time, regulation that is poorly designed or badly implemented can be a cumbersome impediment for business.

Table 2.2: Global Competitiveness Rankings,[a, b] 2010 and 2015

Global	Global Competitiveness Index	Ease of Doing Business
1.	Switzerland (1)	**Singapore (1)**
2.	**Singapore (3)**	New Zealand (2)
3.	**United States (2)**	Denmark (6)
4.	Germany (7)	South Korea (19)
5.	Netherlands (10)	**Hong Kong (3)**
6.	Japan (8)	**United Kingdom (5)**
7.	**Hong Kong (11)**	**United States (4)**
8.	**Finland (6)**	**Sweden (18)**
9.	**Sweden (4)**	Norway (10)
10.	**United Kingdom (13)**	**Finland (16)**
Sub-Saharan Africa		
46.	**Mauritius (57)**	32. **Mauritius (17)**
49.	**South Africa (45)**	62. **Rwanda (67)**
58.	**Rwanda (80)**[c]	72. **Botswana (45)**
71.	**Botswana (66)**	73. **South Africa (34)**
85.	Namibia (74)	97. Zambia (90)
Selected Other Upper Middle Income Countries		
12.	Macedonia (84)	16. Estonia (24)
18.	Malaysia (24)	18. Malaysia (23)
30.	Estonia (35)	48. Chile (49)
32.	Thailand (36)	49. Thailand (12)
35.	Chile (30)	60. Macedonia (32)

Notes:

a. Countries in both measures highlighted in bold

b. Rankings for 2009/10 in brackets

c. The ranking in brackets for Rwanda is for 2010/11 as the country was not included in the 2009/10 survey

Sources: World Economic Forum, World Bank

same countries to indicate the extent to which their performance has changed. At the global level, there is some degree of overlap, with six countries (highlighted in bold) classed as top performers in both the GCI and EDB; however, there is also considerable diversity, confirming that the extent of business regulation is only one dimension of competitiveness. For Africa, the degree of overlap is even greater, possibly indicating the more extensive role played by government in these economies. This is also the case in the leading UMICs, where concerted commitment to improving the business environment has paid dividends in terms of improved competitiveness (the performance of Macedonia is particularly impressive in this respect). For Africa, this is also apparent in the case of both Mauritius and Rwanda, while rankings have generally deteriorated in the cases of South Africa and Botswana, although both countries retain relatively high position within both indices. Overall, Botswana has performed best in terms of the basic requirements including institutional strength and macroeconomic management, but less favourably in relation to the various efficiency enhancers.

2.18 In interpreting these indicators, it is also important to appreciate that both the GCI and EDB are relative measures, meaning that merely maintaining existing levels of competitiveness will not be sufficient if other countries are taking measures to improve theirs.[14] Thus to improve their competitive positions, countries need not only enhance their business environments, but must do so more effectively than their peers.

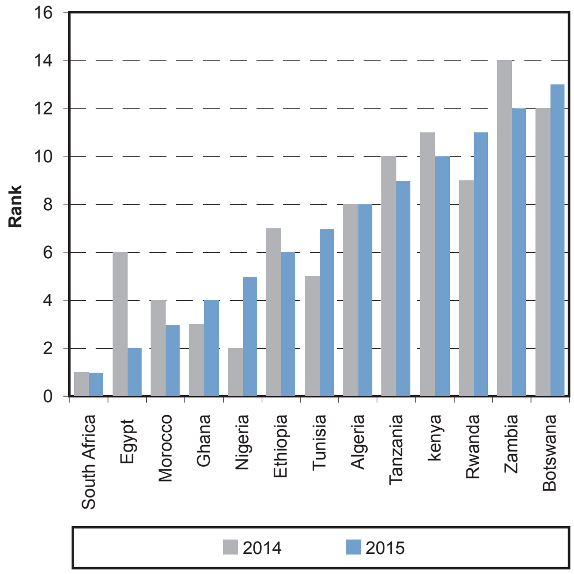
Other Indices and Rankings

2.19 Chart 2.1 shows Africa's most attractive investment destinations, compiled by South Africa's Rand Merchant Bank (RMB). Botswana's ranking of twelfth and thirteenth in 2014 and 2015, respectively, out of 53 is modest at best and is, according to the survey, a result of deterioration in the operating environment (quality of overall infrastructure and business regulations). The attractiveness of Botswana improves to tenth position when membership to a regional economic group[15] is taken into account (Table 2.3). Likewise, when the domestic operating environment is considered, Botswana's ranking gets better. This suggests that, for Botswana, membership to a regional grouping is preferable to a stand-alone position. This is important since the commitment to regional integration (thus increasing effective market size) and a conducive business environment are primarily a result of policy decisions.

14 For example, Doing Business data for the past 12 years shows that between 2003 and 2015, the global average for the time taken to start a new business had more than halved from 53 days to 20 days.

15 The methodology determines whether membership of a regional economic grouping improves a country's attractiveness.

CHART 2.1: MOST ATTRACTIVE INVESTMENT DESTINATIONS IN AFRICA



Source: RMB, Where to Invest in Africa

TABLE 2.3: 2015/16 MOST ATTRACTIVE INVESTMENT DESTINATIONS (TAKING REGIONALISATION AND DOMESTIC OPERATING ENVIRONMENT INTO ACCOUNT)

Regionalisation		Domestic Operating Environment	
Rank	**Country[a]**	**Rank**	**Country[a]**
1.	Mauritius (14)	1.	South Africa (1)
2.	Morocco (3)	2.	Morocco (3)
3.	Ghana (4)	3.	Egypt (2)
4.	South Africa (1)	4.	Ghana (4)
5.	Zambia (12)	5.	Tunisia (7)
6.	Kenya (10)	6.	Mauritius (14)
7.	Egypt (2)	7.	Rwanda (11)
8.	Tunisia (7)	8.	Botswana (13)
9.	Rwanda (11)	9.	Nigeria (5)
10.	Botswana (13)	10.	Ethiopia (6)

a The numbers in parentheses show the country's original ranking, i.e., prior to adjusting for regionalisation and domestic operating environment

Source: RMB, Where to Invest in Africa

2.22 A Composite Operating Environment Index compiled by the RMB (Table 2.4) that combines the independent global assessments from the WEF, World Bank, Transparency International and the Heritage Foundation shows Botswana as having the second best operating environment in Africa, after Mauritius, which is relevant for competitiveness and the potential to continue to attract investors.

TABLE 2.4: COMPOSITE OPERATING ENVIRONMENT INDEX - TOP FIVE AFRICAN COUNTRIES

Rank	Country	Score
1	Mauritius	Good
2	Botswana	Good
3	Rwanda	Good
4	South Africa	Moderately Good
5	Ghana	Moderately Good

Source: RMB, Where to Invest in Africa

Key Interlinkages and Challenges

2.21 Unemployment, productivity and competitiveness have thus far been considered mainly in isolation. However, it is important to recognise the key inter-linkages and, in turn, the resulting challenges that face economic policymakers.

2.22 Although competitiveness is closely related to productivity, they are distinct concepts. Importantly, productivity is neither a necessary nor sufficient condition for competitiveness. It is possible to have situations where low productivity is nonetheless competitive (if input prices are sufficiently low) or, conversely, where high productivity is nonetheless uncompetitive, because wages and other costs are too high. However, while it is possible for businesses or economies characterised by low productivity to remain competitive, it is not possible to remain as competitive while increasing remuneration to factors of production, unless productivity is also increasing. Thus, productivity is essential for prosperity.

2.23 The linkage between competitiveness and unemployment is not clear cut. Clearly, uncompetitive labour will not be employed (or, if employed, will not remain so for long). But, to the extent that unemployment is due to weak aggregate demand (i.e., it is cyclical or Keynesian in nature), a prescription based on lower real wages in order to make labour more competitive may not be effective. For this reason, it is very important to have a well-based view not just on the extent of unemployment, which is itself not a straightforward task, but also of the underlying causes.

2.24 The link between productivity and unemployment is also problematic or, more precisely, the implications of that link. As already mentioned, increased labour productivity means that, by definition, the same amount of output can be produced with less labour; thus, if output is constant, unemployment will result from higher productivity. This underlies the concern that policies to improve productive efficiency, such as privatisation for example, may result in job losses.

2.25 Overall, therefore, translating productivity and competitiveness into sustained growth and employment creation requires governments to effectively address the paradox that, in many instances, increased productivity will be labour saving. This requires creating a flexible and dynamic economic environment, where the natural redundancy arising from technological progress is more than offset by the emergence of new opportunities and not by an attempt by government to have a direct role in job creation. Here, key policy choices face many countries in Africa (and elsewhere) to achieve a "demographic dividend", based on growth and rising living standards rather than a "demographic time bomb" in the form of prolonged and chronic youth unemployment.

3. Unemployment, Productivity and Competitiveness in Botswana

Historical Trends/Developments in Unemployment, Productivity and Competitiveness

3.1 Botswana has had a long-standing unemployment problem, even prior to independence, which was reflected in migrant labour working outside the country, low-productivity and, hence, only low income employment opportunities, mainly in drought-prone agriculture. Large scale unemployment was apparent in the absence of significant formal economic activity, apart from an emergent civil service. Subsequently, however, the profile of unemployment in Botswana has changed, reflecting the transition from the low-income, mainly subsistence rural economy at the time of independence to a modern, upper middle-income economy, where the majority of the population resides in urban areas and the formal sector is the main source of employment. A key feature of this transition has been the increasing concentration of unemployment in cohorts with higher qualifications as access to post-primary and post-secondary levels of education rapidly expanded.[16]

Total and Working Age Population

3.2 The population of Botswana has grown continuously since independence, albeit with a declining rate of growth observed in every Population and Housing Census since 1971 (Table 2.5). In the 40-year period from 1971, the population increased at an average annual rate of 3.2 percent (from 574 094 in 1971 to 2 024 904 in 2011), of which 48.8 percent were male and 51.2 percent female.

Table 2.5: Population and Working Age Population Growth Rates, 1972 – 2011 (Percent)

Period	Total Population	Working Age Population
1971 – 1981	5.1	5.4
1981 – 1991	3.5	4.2
1991 – 2001	2.4	3.6
2001 – 2011	1.9	2.6

Source: Statistics Botswana

3.3 Alongside the overall increase in population, the working age cohort (i.e., those aged between 15 and 64) increased by an average of 3.4 percent per annum between 1971 and 2011; the slightly faster increase reflected more rapid growth among the younger age cohorts as a result of declining rates of infant and child mortality. However, growth in the working age population was weighed down by falling birth rates and the impact of the HIV/AIDS pandemic. It is also notable that the male work-

16 Thus, what emerged in the period following independence as a "Standard 7 Leaver Problem" has gradually evolved through, first, junior and then senior secondary education as major problem areas for unemployment. While this still remains broadly the case, the emerging concern is the increasing number of those with tertiary education who are unemployed.

TABLE 2.6: LABOUR FORCE PARTICIPATION 1981 – 2011 ('000)

Year	Economically Active (1)			Total Working Age Population (2)			LFPR (Percent) (3) = (1)/(2)		
	Male	Female	Total	Male	Female	Total	Male	Female	Total
1981	188.3	127.2	315.5	258.1	311.7	569.8	73	41	55
1991	271.4	169.8	441.2	393.2	450.8	844.0	69	38	52
2001	330.4	259.4	589.8	567.1	622.6	1 189.7	58	42	50
2011	439.7	358.4	798.1	653.0	707.2	1 360.1	67	51	59

Source: Statistics Botswana

ing age population has grown more rapidly, reflecting reduced numbers of working age males migrating out of the country in search of employment. Nonetheless, as of 2011, females still accounted for the majority (51.3 percent) of the working age population.

Labour Force, Unemployment and Formal Sector Employment

Labour Force Participation

3.4 Labour force participation has increased from 55 percent in 1981 to 59 percent in 2011 (Table 2.6), but with contrasting trends for males (a decrease from 73 percent to 67 percent) and females (an increase from 41 percent to 51 percent). It is noticeable, however, that the male LFPR continues to be higher than that for females. Overall, these changes can be attributed to a number of factors, including increased prospects for female participation in the labour force, and improved access to education providing greater opportunities for people (mainly younger) to delay their entry into the labour force.

3.5 Botswana's labour force participation rate is lower than that of its comparator countries in Africa, being only better than South Africa among the selected countries; this is generally true for both the male and female LFPRs (Table 2.7). However, Botswana is better than Mauritius with respect to the female LFPR. Notably a number of African countries that fare better than Botswana have high female participation rates. At the same time, most of the comparator countries have experienced an increase in the female LFPRs while that of males has tended to decline, somewhat similar to that of Botswana. Considering developments in comparator countries, it would seem that there is scope for an increase in both the male and the female labour force participation rates in Botswana if growth in productive employment opportunities can be accelerated sufficiently.

TABLE 2.7: LABOUR FORCE PARTICIPATION RATES (PERCENT)

Country	Year	Total	Male	Female
Botswana	2011	58.7	67.3	50.7
Ghana	2013	79.6	82.2	77.3
Lesotho	2013	65.2	74.0	57.3
Malawi	2013	74.7	75.1	74.3
Mauritius	2014	59.8	75.1	45.1
Namibia	2013	71.0	74.3	73.1
Rwanda	2012	73.6	75.6	71.7
South Africa	2014	53.3	60.8	46.4
Uganda	2013	85.9	88.2	83.8
Zambia	2012	74.4	79.7	69.3
Zimbabwe	2012	66.8	76.8	58.1

Source: International Labour Organisation, Statistics Botswana

Table 2.8: Population Engaged in Formal Sector, Informal Sector and Traditional Agricultural Activities, 1971 – 2011 (‘000)

		Employed					
Year	Economically Active	Traditional Agriculture	Other, of which:	Formal	Informal	Unemployed	Unemployment (Percent)
1971	–	231.0	51.4	37.5	13.9	–	–
1981	315.5	143.8	139.4	97.4	42.0	32.2	10.2
1991	441.2	67.6	312.3	228.9	83.4	61.3	13.9
2001	589.8	17.6	457.3	270.6	186.7	114.9	19.5
2011	798.1	98.2	541.0	388.0	153.0	159.0	19.9

Source: Statistics Botswana (Population and Housing Censuses and relevant surveys for formal sector employment)

Employment: Formal Sector, Informal Sector and Agriculture

3.6 In the forty-year period from 1971, the number of persons employed in both the formal and informal sectors (including those engaged in periodic piece work) grew at an average annual rate of 6.1 percent (Table 2.8). Formal sector employment grew at an average rate of 6 percent per annum, while informal sector employment grew at an estimated rate of 6.2 percent. However, the population engaged in traditional agriculture is estimated to have decreased by an average annual rate of 2.1 percent in the same period.[17] Thus, the overall growth in employment was 2.1 percent compared to growth of 3.4 percent in the working age population in the same period.

3.7 Since 1981, the labour force has grown at an average annual rate of 3.1 percent, while the number of persons unemployed and actively looking for work has grown by 5.5 percent per annum. That difference is reflected in the increase of the unemployment rate from 10.2 percent to 19.9 percent in the 30-year period to 2011. Estimates of unemployment since 1981 from sources other than the population censuses[18] are also broadly consistent with this trend. The most recent estimate for the national rate of unemployment is 20 percent in 2013,[19] with rates of 17.8 percent and 2 percent for males and females, respectively (since records began, the unemployment rate for males has always been below that of females, averaging about 75 percent of the female unemployment rate).

3.8 In terms of both formal and informal sectors employment outside of traditional agriculture, growth over the period has been robust, averaging 4.7 percent per annum for the former and 4.4 percent per annum for the latter, both greater than the 3.1 percent average annual rate of labour force growth. In large measure, the increase in unemployment can be attributed to the reduction in employment opportunities in traditional agriculture, where the number of persons engaged over the period from 1981 declined from 143 805 to 98 182.

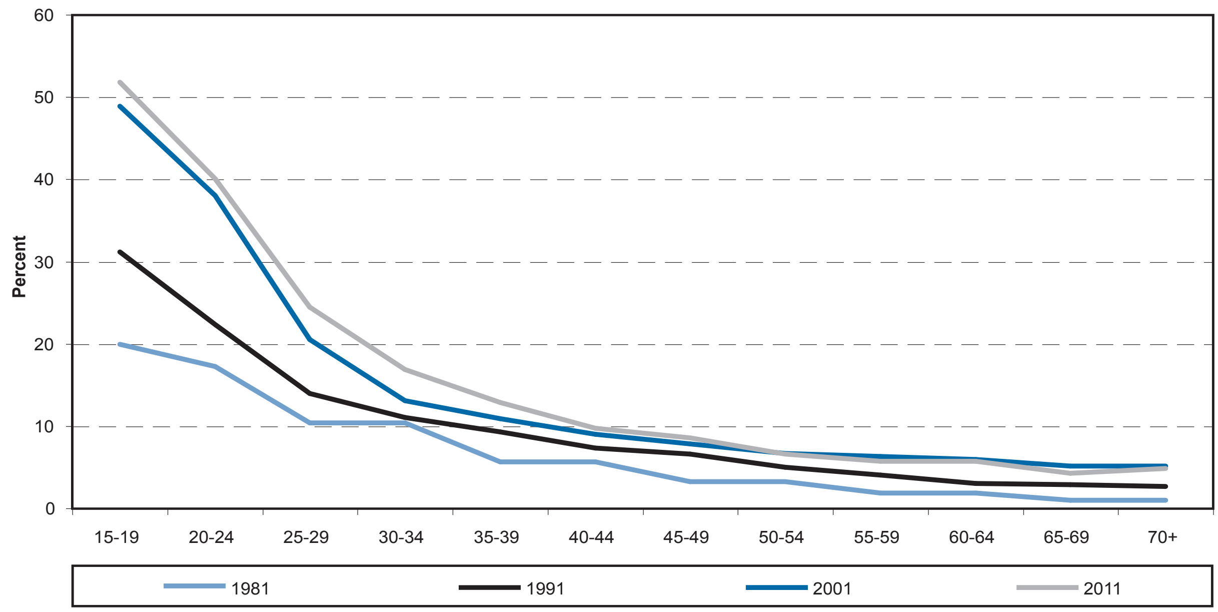
3.9 As shown in Chart 2.2, as the national unemployment rate has trended upward since 1981, the unemployment rates for all age cohorts have risen, especially for the youth cohorts, age 15 - 19, 20 - 24 and 25 - 29. For those aged 15 - 19, the unemployment rate rose from 20 percent in 1981 to 51.8 percent in 2011, with an especially sharp rise in the decade to 2001. The

17 The decline in employment in traditional agriculture reflected patterns of growth in the formal economy, together with trends in assistance by government for small scale farmers. Thus there was initially a sharp decline, which was, in part, reversed between 2001 and 2011.

18 The sources include dedicated Labour Force Surveys, together with other surveys which also asked questions regarding respondents’ employment status. Although these surveys provide valuable information on trends in unemployment, the results are typically reported only after a considerable lag, with the result that up-to-date estimates are not available. This is detrimental to reasoned discussion and analysis of what is a highly topical issue and falls considerably short of best practice for labour market indicators (as set out in the Special Data Dissemination Standard (SDDS) of the IMF).

19 The 2013 Botswana AIDS Impact Survey.

CHART 2.2: UNEMPLOYMENT RATE BY AGE COHORT 1981 - 2011



Source: Statistics Botswana

unemployment rate for the 20 - 24 year old age cohort also rose dramatically from 17.3 percent to 40.1 percent in the 30-year period (with the unemployment rate rising by 15.6 percentage points to 38 percent in the ten-year period to 2001). Similarly, the unemployment rate for the 25 - 29 year old age cohort almost doubled from 10.4 percent in 1981 to 20.6 percent in 2001 and rose further to 24.5 percent in 2011.

3.10 In contrast, the increase in unemployment was less pronounced for the older age groups with unemployment rates consistently lower than those for the youth, with a negative relationship as one moved to higher age cohorts that tapered off to around 5 percent for the cohorts 50 years of age or higher. This negative relationship between age and the unemployment rate is sometimes interpreted to mean that the unemployment problem dissipates with age and time. This may be true to a certain extent, especially in cases where expectations regarding employment among young people that were initially set too high are set more realistically as they become older. But it can also mean that those who are unemployed on a long-term basis withdraw from the economically active population, thus contributing to what is described as hidden unemployment. There may be some evidence of this latter effect to the extent that in the most recent census the LFPR for old age groups has declined from the higher levels seen previously.

3.11 In relation to other African countries, Botswana's unemployment rate (20 percent) in 2013 (Table 2.9), is relatively high, although broadly comparable with some members of the Southern African Customs Union (SACU; i.e., Lesotho (24.4 percent), Namibia (29.7 percent) and South Africa (24.9 percent)). This has led to some speculation that the economic and social structure of SACU member countries may be particularly prone to unemployment, at least as captured in these statistics. In contrast, in other African countries, unemployment is significantly lower (typically in single digits), possibly reflecting a greater capacity for agriculture and informal sector activity to absorb surplus labour. Outside Africa, unemployment in countries with which Botswana is often compared (in this case, Chile, Malaysia and Singapore) is significantly lower, at levels that would generally be considered as representing full employment. The considerations for Botswana in seeking to emulate these countries are considered in more detail in Section 6.

3.12 In terms of gender, Botswana is generally in line with most of the other countries reviewed,

Chart 2.3: Youth Unemployment (Percent of Labour Force aged 15-24)

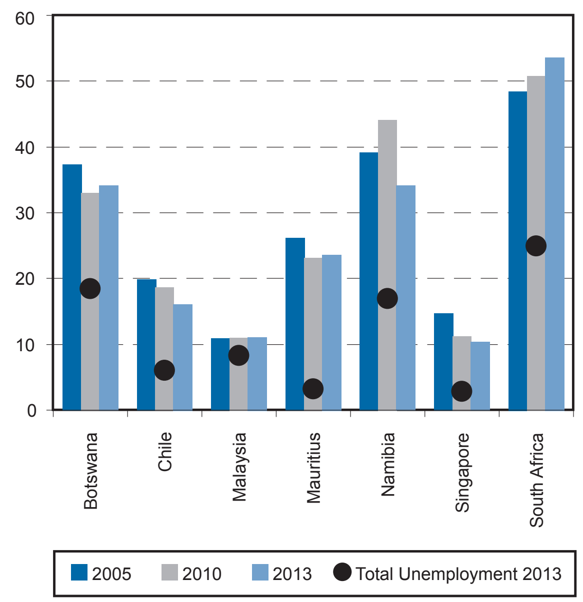
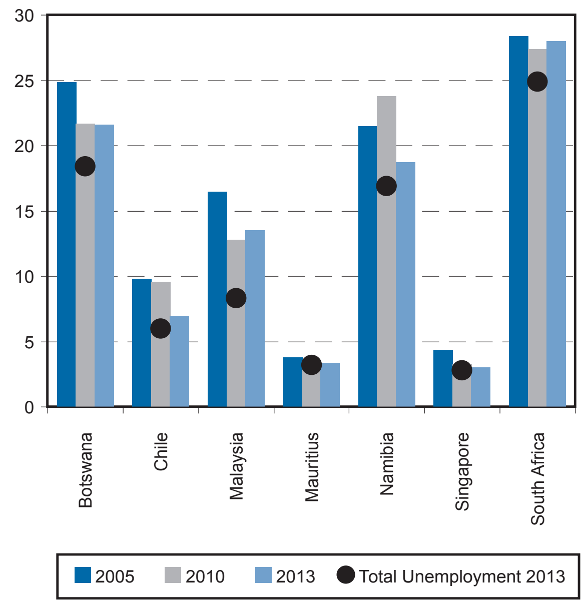


Chart 2.4: Female Unemployment (Percent of Labour Force)



Source: World Bank

all of which show, to a greater or lesser extent, higher levels of unemployment for women than men. The ratio of the male unemployment rate to the female rate for Botswana was 80 percent in 2013 (Table 2.9). Fairly similar ratios of male to female unemployment rates were found in Southern African; Lesotho (81 percent) and Namibia (78 percent). In Zambia, the female unemployment rate (7.9 percent) was almost at the same level as the male rate (7.8 percent). The difference is more pronounced in Mauritius and Zimbabwe where the female unemployment rate was more than twice as large as the male unemployment rate. The much higher unemployment rates for females in Mauritius, in conjunction with the much lower female labour force participation rates, poses questions regarding the success of their development model and lessons that can be gained from it.

Migrants: Inward and Outward

3.13 Botswana has experienced two disparate trends with respect to migration. Historically, for many years prior to independence, substantial numbers of Batswana migrated to South Africa for work. At the time of the 1971 census, an estimated 45 735 citizens of Botswana (about 8 percent of the population) were living outside the country (Table 2.10), mainly in South Africa.[20] The number of Botswana citizens living abroad has steadily decreased in each subsequent census, to 23 032 in 2011. This partly reflects the reduced migration to work in the South African mines, as well as the growth in employment opportunities in Botswana, partly offset by numbers of students and skilled workers living outside Botswana.

3.14 In contrast, the number of non-citizens living in Botswana has increased steadily over the period since 1971 from 10 861 to 111 485 in 2011, an average annual rate of increase of 6.8 percent. There are both push and pull factors that can explain such growth. In the early years after independence, when only a small number of citizens had any post-secondary education and/or training, there was an acute shortage of skilled manpower. Even as the economy of Botswana develops, new economic activities emerge that involve advanced technology and manpower shortages can develop that can best be addressed through imported skills, while programmes are being designed to address the

20 Even then, there was speculation that the census had seriously under-estimated that number by more than a third.

TABLE 2.9: UNEMPLOYMENT RATES

Country	Year	Unemployment Rate (Percent)			Ratio: Male to Female Rate
		Total	Male	Female	
Botswana	2013	20.0	17.8	22.3	0.80
Africa					
Ghana	2013	5.2	4.8	5.5	0.87
Lesotho	2013	24.4	22.1	27.2	0.81
Malawi	2013	6.4	6.1	6.7	0.91
Mauritius	2014	7.7	5.4	11.4	0.47
Namibia	2013	29.7	25.8	33.1	0.78
Rwanda	2012	3.4	2.8	4.0	0.70
South Africa	2014	24.9	23.1	27.0	0.86
Uganda	2013	1.9	1.4	2.4	0.58
Zambia	2012	7.9	7.8	7.9	0.99
Zimbabwe	2014	11.3	7.3	14.9	0.49
Other Comparator Countries					
Chile	2013	5.9	5.3	6.9	0.77
Malaysia	2013	2.9	2.7	3.2	0.84
Singapore	2013	2.8	2.7	2.9	0.93

Source: International Labour Organisation, 2013 Botswana AIDS Impact Survey

skills gap in the longer term. In this regard, the relevant expatriate manpower coming into Botswana can help to address impediments to development and should overall be in the country's interest, in particular to fill the skills gap and/or coming alongside foreign direct investment.

3.15 On the push side, other countries which do not perform well in generating employment opportunities may induce their population to move to better destinations; and this has certainly been the case for some of the migration to Botswana, especially from countries in the region. Depending upon how this is managed and the skills and resources such migrants bring, such migration can also be in Botswana's best interest.

TABLE 2.10: CITIZENS OUTSIDE BOTSWANA AND NON-CITIZEN MIGRANTS TO BOTSWANA

Period	Citizen Out-Migrants	Non-Citizen Residents
1971	45 735	10 861
1981	42 069	15 677
1991	38 606	29 557
2001	28 210	60 716
2011	23 032	111 485

Source: Statistics Botswana

Gross Domestic Product, Labour Productivity and Elasticity of Employment

3.16 Between 1981 and 1991 real GDP increased at an average annual rate of 10.7 percent. All sectors of the economy, except agriculture, registered double-digit rates of economic growth, with especially high rates for transport and communications (18.8 percent), social and personal services (18 percent) and finance, real estate and business services (16.5 percent). GDP growth was lower in the subsequent inter-censal periods, with average annual growth rates of 4 percent and 4.4 percent in the decades to 2001 and 2011, respectively. However, relatively higher growth rates were recorded for manufacturing, trade, hotels and restaurants, transport and communications, finance, real estate and business services and social and personal services. Overall, for the period 1981 to 2013, total GDP and non-mining GDP growth averaged 6.3 percent and 7.4 percent, respectively.

3.17 Comparing formal sector employment[21] with output provides a measure of labour productivity (output per worker). Table 2.11 shows average rates of labour productivity growth since 1981, both for the economy as a whole and excluding the mining and general government sectors. Overall, the generally positive levels of labour productivity growth, especially since 1991, were supportive of a steady increase in living standards for those in formal employment and, thus, supported competitiveness of producers in Botswana.

Table 2.11: Productivity Growth 1981 - 2011

Period	Overall	Excluding Mining and Government	Comment
1981 – 1991	1.7	1.6	Very rapid growth in labour productivity in mining (11.1 percent per annum) as production increased sharply, offset by decreases in labour productivity in other sectors, including manufacturing as the sector diversified into more labour intensive activities where labour productivity was low compared to the established beef and beverages industries.
1991 – 2001	2.4	4.6	All sectors showed increased labour productivity, especially in mining and among the service sectors.
2001 – 2011	2.1	4.9	Overall decline driven by mining where output fell while employment increased. Except for water and electricity, all other sectors recorded positive labour productivity growth.

Source: Own calculations

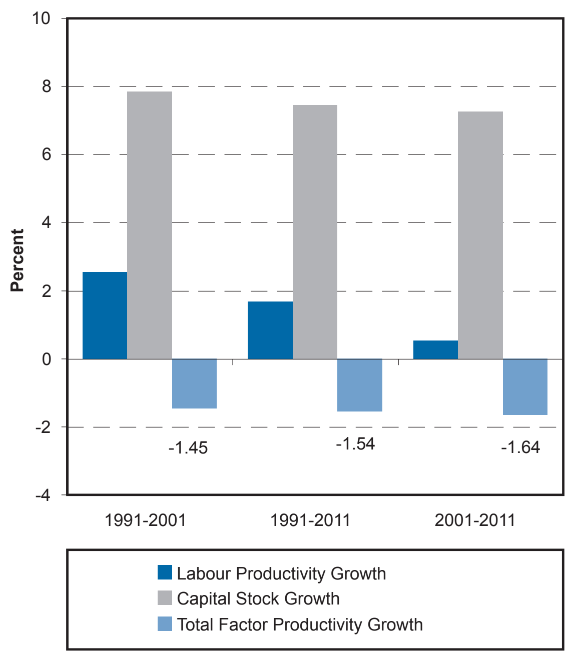
3.18 However, this picture is more nuanced when viewed from the perspective of other indicators, including the broader measure of TFP described in Section 2, as illustrated in Chart 2.5 using data for 1991 to 2011. It shows that the continued growth in output per head has been due, in large part, to the expansion of the capital stock. Moreover, in this period, growth in total factor productivity was negative, suggesting that the economy has been functioning increasingly less efficiently.

Elasticity of Employment

3.19 The data on formal sector employment and sectoral output also allows for investigation of the responsiveness of employment to changes in output; i.e., the elasticity of employment with respect to output, or how much employment changes when there is a change in output. It is measured by the percentage change in employment divided by the percentage change in output over any period. For example, over the period 1981 to 1991, total formal sector employment increased by 135 percent compared to cumulative output growth of 176.9 percent. Thus, for each one percent change in output there was a 0.76 (=135/176.9) percent change in employment or an employment elasticity of 0.76.

3.20 Similarly, for the period 1981 to 2013, the

Chart 2.5: Trends in Labour Productivity, Capital Stock and Total Productivity Growth



Source: Ministry of Finance and Development Planning

21 This is largely appropriate given that the informal sector and subsistence agriculture makes only a very small contribution to measured GDP in Botswana.

average estimated employment elasticity for the economy as a whole is 0.41. This can help provide some focus for addressing employment creation in Botswana. For example, with GDP growth forecasts in the range of 3 - 5 percent per annum in the next 20 years, on the basis of past trends, employment growth would be projected in the range of 1 - 2 percent per annum. This is probably not enough to keep pace with the expected growth in the labour force; and certainly not enough to make any major impact in the high double digit unemployment rates that Botswana has been registering, especially among the youth. Thus, a change in direction with respect to drivers of growth and related policies is warranted. This should focus on accelerating growth to levels at, or higher than, the upper end of the rates currently envisaged and/or promoting sectors with higher employment elasticity. A more explicit focus on promoting labour-intensive employment should, however, be approached cautiously, given that this may tend to support growth based on low productivity, thus limiting scope for rising living standards in the longer term.

3.21 Given non-mining growth since the early 1980s averaging in excess of 7 percent, it is hard to conclude that the shortfall in employment growth has been due to generally-deficient domestic demand. Thus other factors should not be ignored, perhaps especially as they might impact on the chronic problem of youth unemployment. In this regard, as explained in the previous Section, it is relevant to look at the prevalence of conditions that might foster structural and, in some instances, "voluntary" unemployment in the country.

4. GOVERNMENT POLICIES AND INSTITUTIONS THAT INFLUENCE PRODUCTIVITY, COMPETITIVENESS AND EMPLOYMENT CREATION

4.1 The ability to produce goods and services at costs that are commensurate with quality and prices (relative productivity and competitiveness) prevailing in the target markets is particularly important for small, open economies such as Botswana, which are relatively undiversified and rely on trade (specifically exports) and/or foreign direct investment (FDI) to provide the scale necessary to drive improvements in living standards. In this respect, government can impact on competitiveness through macroeconomic policies and the microeconomic dimensions of regulation and administrative capacity. Critically, there is need for proper alignment of policies, institutional support and facilitation by Government to promote rather than undermine or disrupt business and other economic activity.

(a) Macroeconomic Policy

4.2 Thus, fiscal, monetary, exchange rate and trade policies are relevant at the macroeconomic level. The 2015 Monetary Policy Statement and others before highlight the benefits of the existing monetary policy framework: a low and predictable level of inflation and a conducive financial environment to foster savings mobilisation, productive investment and international competitiveness of domestic producers and, thus, contribute towards the broader national objective of sustainable economic diversification and development. In this respect, price stability is defined as a sustainable level of inflation that is within the medium-term objective range of 3 – 6 percent. The policy framework has been largely successful in moderating both the level and expectations of inflation. Additionally, policy is formulated with a view to safeguarding the soundness and stability of the financial system, which is key to effective financial intermediation and the conduct of economic transactions.

4.3 Similarly, the exchange rate policy, through the crawling band arrangement, supports the competitiveness of domestic producers of tradeable goods and services in that any sustained differential between inflation in Botswana and trading partner countries inflation is corrected by the gradual adjustment of the nominal effective exchange rate, in order to maintain competitiveness. To be aligned to the competitors, the Pula is pegged to a basket of currencies (SDR and the rand) with weights based on the trade pattern. The basket arrangement also helps to moderate fluctuations of the Pula against any individual trading partner currency. The policy parameters (weights and rate of crawl) and their determination are also publicly disclosed to aid economic decision-making and expectations. Since the adoption of the crawling band, the real effective exchange rate of the Pula has been relatively stable, albeit with marginal appreciation. Productivity increases and appropriate alignment of factor costs must, therefore, accompany the exchange rate channel in order to have more competitive industries.

4.4 Fiscal policy (particularly taxation policy) is also relevant for investment, allocation of resources and pricing decisions, especially in competition with other jurisdictions, has also been used to enhance the country's competitiveness. Botswana's taxation regime is internationally competitive (Table 2.12). For example, resident companies pay a company tax rate of 22 percent plus a general withholding tax rate of 7.5 percent on all dividends. Moreover, manufacturing enterprises and businesses operating in the Innovation Hub and the International Financial Services Centre pay a lower tax rate of 15 percent. A tax holiday (zero corporate tax) can be availed to investors for a period of 5 years to 10 years, while further concessions through Development Approval Orders may be available in exceptional circumstances. The absence of foreign exchange controls also means that companies are free to repatriate profits, dividends and capital. However, the relatively low company tax rates and absence of exchange controls need to be supplemented by other factors, which impact on productivity and profitability of businesses operating in Botswana.

Table 2.12: Corporate Tax in Selected Economies in 2015 (Percent)

Country	2015
Botswana	22
SADC	
Mauritius	15
South Africa	28
Namibia	33
Angola	35
Upper Middle Income Countries	
Chile	22.5
Malaysia	25
Thailand	20
Mexico	30
Developed Economies	
UK	20
USA	40
Japan	33
Germany	30

Source: KPMG

(b) Trade and Industrialisation Policies

4.5 The industrialisation and trade policies and related institutional arrangements operate in the context of an open economy with no exchange controls. Botswana continues, in the main, to pursue an outward-looking strategy in order to both support market expansion and easy access to imports. Thus, among others, trade agreements and efforts towards regional integration aim at facilitating market access and easing constraints to trade. The policy also entails attraction of FDI, which is critical as a source of new investment capital, expansion of production and economic activity, promoting skills and technology transfer, enhancing market access, and, as a result, serves as a catalyst for expediting economic diversification. The industrialisation policy also encompasses development of the private sector (including privatisation of parastatals), entrepreneurship and fostering access to finance. The following points highlight some of the key initiatives aimed at promoting industrialisation and trade.

Privatisation

4.6 The Public Enterprises Evaluation and Privatisation Agency (PEEPA) spearheads the privatisation initiative and advises the Government on appropriate strategies and sets performance targets for public enterprises. The Privatisation Policy of 2000 and Master Plans of 2005 and 2012-2017 provide the broad framework for the commercialisation and, ultimately, sale of a wide range of state-owned enterprises to private investors. The assumption is that privatised entities will be more efficient in providing relevant products, services and utilities and thus contribute positively to national output and employment creation, as well as ease the burden on government finances. In this regard, several state-owned enterprises, including the National Development Bank, Botswana Telecommunications Corporation Limited and Air Botswana, have been or are actively being considered for privatisation, while outsourcing of services previously provided by the Government is also being undertaken.

4.7 However, the pace of privatisation has been slow for reasons that include: weak performance and the low value that can be derived from the sale with respect to some entities; concerns about possible job losses; and difficulty in concluding complex apportionment of shareholding (for example, requirements for retention of significant share by the Government, citizens and employees) and how this is funded. In this regard, productivity and output improvements arising from privatisation are yet to be realised, while disruptions relating to effective delivery of key infrastructure and inputs appear to intensify. Nonetheless, for reasons elaborated on in the next section, it remains important for the Government to continue to pursue privatisation.[22]

Special Economic Zones and Cluster Development

4.8 As part of the industrialisation and economic diversification strategy, the Government has introduced the Special Economic Zones (SEZ) Policy and adopted the related legislation to attract domestic and foreign investors to designated zones across the country. It is envisaged that the zones will offer an enhanced, competitive and investor-friendly environment with fast-tracked and streamlined authorisation and licensing of businesses. The policy will be implemented in phases, each targeted at specific industrial sectors.[23]

4.9 The initiatives covered in the Cluster Development Strategy are also relevant in this regard.[24] Broadly, cluster development refers to concentration of complementary businesses that create productive synergies and value chains arising from geographic proximity and interdependence of companies and institutions in a particular field. The development of clusters in Botswana is premised on potential for enhanced industrialisation and export diversification based on natural endowments and areas where there has been good performance, specifically diamonds, tourism, beef, mining, health and financial services. It is envisaged that a National Cluster Development Strategy will be implemented as part of NDP 11.[25] In terms of relationship with other initiatives, cluster-based development is a feature of the Innovation Hub and the planned SEZs.

4.10 Cluster development is also undertaken in the context of economic "hubs", established in 2008 to coordinate activities in various sectors, including agriculture, diamonds (promoting downstream beneficiation), transport, health, education and innovation, with the last two hubs aimed at transforming Botswana into a knowledge economy. In some cases, the hubs'

22 While privatisation efforts have not taken off as envisaged, PEEPA has had some success with public enterprises rationalisation, as the merger of some parastatals (for example Botswana Technology Centre and Rural Industries Promotion Company as well as BEDIA and IFSC) has been successfully completed. The privatisation of the Botswana Telecommunications Corporation also appears to be gathering pace.

23 The first phase will cover the Sir Seretse Khama International Airport (SSKIA) mixed use site and the Selebi-Phikwe Economic Diversification Unit (SPEDU) sites. The second phase covers Lobatse, Gaborone Fairgrounds, Pandamatenga and Palapye, while the third phase covers Francistown and the Tuli Block.

24 Cluster Development Strategy came to prominence in 1990 following a book by Professor Michael Porter, "The Competitive Advantage of Nations". This strategy was embraced by the Government of Botswana following Professor Porter's presentation to the Economic Committee of Cabinet in 2012. An announcement on the adoption of the cluster development strategy in Botswana was first made to the High Level Consultative Council in 2013.

25 In support of this initiative, the National Strategy Office (NSO) has been assigned responsibility to undertake an in-depth study to provide the relevant baseline information.

mandate encompasses the development of relevant infrastructure; while for others, the emphasis is on facilitating a conducive operating environment, including through targeted government support.

Economic Diversification Drive (EDD)

4.11 The Economic Diversification Drive (EDD), which commenced in 2010 is intended to promote growth in the private sector through two distinct components. In the short-term, preferential treatment of local suppliers and producers for public procurement mobilises government purchasing power in support of domestic businesses. Since the programme commenced in 2010, this phase has resulted in more than P18 billion worth of goods and services being purchased, with approximately 1 400 businesses (in turn, with combined employment of 40 333 employees) registered as EDD suppliers.[26]

4.12 In the medium-to-long-term, however, the objective is to identify and implement strategies to develop local industries that can operate with little or no need for government support, contributing positively to the domestic value chain. Areas that are currently receiving support, with a view to both promoting exports and reducing dependency on imports, include dairy production, leather products and utilising domestic salt resources. To be successful in meeting these ambitious objectives, there is need to carefully manage the challenge of transitioning between the two phases of the programme (that is, reducing dependency on government), minimising associated bureaucracy, and maintaining a focus on a few key sectors targeted for assistance.

4.13 Regarding industrialisation and trade policies generally, it is clear that, given related or similar initiatives (privatisation, SEZs, cluster development, hubs, EDD, etc.) towards the same end, there should be coordination to optimise on resources and benefit from the initiatives. Evidently, the provision of efficient infrastructure, supportive land allocation policies and business registration and licensing procedures, as well as access to requisite services and skills and other inputs, would be critical for the success of the efforts relating to industrialisation.[27]

(c) Selected Business Support Institutions

4.14 The broad strategies highlighted above are complemented by various institutions set up to promote entrepreneurship, business development, as well as local industry productivity and competitiveness (Table 2.13).

4.15 The BNPC in particular, is modelled on the Singapore approach. Therefore, a comparison of progress in the two countries in the attainment of high productivity levels is illuminating. Singapore went through three stages of the productivity movement.[28]

(i) *Awareness*: where the focus is on positive attitudes towards work, through public education, strengthening corporate identity, and promotion of joint consultation between management and labour promoting productivity in the public sector. A national productivity council was also formed.

(ii) *Action*: in order to translate awareness into specific programmes that improve workplace productivity, for both management and workers.

(iii) *Ownership*: which entails encouraging ownership of the productivity movement and making it self-sustaining.

4.16 Singapore progressed through all these stages in about ten years (from 1981 to the early 1990s). By contrast, Botswana is still in the Awareness stage after more than 20 years. Indeed, the Global Competitiveness Reports still regularly cite a poor work ethic as one of the factors contributing to slowing economic growth in Bot-

26 Republic of Botswana, State of the Nation Address, 2015

27 See Zeng, D. Z. (2015), 'Global Experiences with Special Economic Zones – with a Focus on China and Africa', available at http://www.worldbank.org/content/dam/Worldbank/Event/Africa.

28 The discussion on BNPC draws on a paper by Kitaw, D., (2011), 'Botswana Productivity Movement', Kaizen National Movement – A Study of Quality and Productivity in Asia and Africa, available at www.grips.ac.jp.

Table 2.13: Government Institutions/Programmes Influencing Productivity, Competitiveness and Employment Creation

Institution	Mandate	Success/Achievements
Botswana National Productivity Centre (established 1993)	• To provide guidance on productivity related matters. • To enhance productivity in Botswana through both advocacy and training and other advice (for example, assisting organisations to adopt best management practices).	BNPC has a long way to go in achieving its mandate as it has not yet managed to translate productivity awareness into actionable programmes that improve workplace productivity. Furthermore, there is a low uptake of BNPC's services, especially outside the public sector and by smaller enterprises, partly due to perceived high consultancy fees which may require some revision to the centre's current funding model.
Botswana Investment and Trade Centre (established 2011)	• Investment promotion and attraction, export promotion and development. • Serves as a "one stop" service centre for investors which should ideally help to minimise regulatory and bureaucratic costs. In particular, BITC provides business facilitation services such as company and business registration, trade licence applications and entry visas, work and residence permits.	Thus far, there are 35 International Financial Services Centre (IFSC) registered companies which have employed 1 275 citizens. In addition, BITC has attracted 16 companies, during 2013/14, on the FDI front involved in manufacturing, agriculture, tourism, diamond cutting and polishing and financial and business services. The combined projected capital investment is P462.9 million with a projected creation of 2 098 jobs, once the companies are fully operational. During 2014/15, over 3 000 jobs were created (surpassing a target of 2 400 jobs) mostly through business expansions of companies attracted by BITC. Total capital investment was P3.2 billion, against an annual target of P1.16 billion. Furthermore, BITC has been mandated with the roll-out of the Special Economic Zones programme.
Competition Authority (established 2009)	• To prevent any anti-competitive conduct in the economy. • Advise Government on domestic legislation and international agreements that may have an impact on competition. • To investigate complaints of anti-competitive conduct (including bid rigging and price fixing, for example) • Approval of proposed mergers and acquisitions involving domestic enterprises.	The Authority is making good progress handling anti-competitive behaviour cases. The cases handled increased from 18 in 2011/12 to 61 in 2013/14.
Citizen Entrepreneurial Development Agency (established 2001)	• To provide support for business development through various funding mechanisms. • Targets agro-business, services property and manufacturing through subsidised loans, as well as helping citizens partner with non-citizens in joint ventures (through structured finance). • Fosters citizen entrepreneurship and empowerment and promotes economic diversification. • Encourages the development of competitive and sustainable citizen enterprises. • Creates sustainable employment opportunities.	Since 2008, CEDA has funded 2 288 enterprises with a total of nearly P2.1 billion. The firms employed more than 11 000 people.

(continued overleaf)

Table 2.13: Government Institutions/Programmes Influencing Productivity, Competitiveness and Employment Creation (continued)

Local Enterprise Authority (established 2004)	• To promote entrepreneurship and enterprise development in Botswana. • Provides business development services such as screening, business plan facilitation, training and mentoring, among others. • Identifies business opportunities for existing and future SMMEs. • Promotes domestic and international linkages, especially between SMMEs and Government, large business entities and other SMMEs. • Facilitates changes in regulations, quality management systems and standards, infrastructure and access to finance. • Facilitates technology adoption and diffusion; and promotes general entrepreneurship and SMME awareness.	LEA has made some progress as it managed to register some 114 new SMMEs, for example, in 2013/14 for purposes of business training, mentoring and coaching. Since inception and up to 2014, LEA has screened 14 697 clients and registered 8 330, creating 6 998 jobs in the process. As regards training, 43 893 individuals have attended entrepreneurship awareness workshops, while 12 013 have been trained on various courses, coached and mentored.
Youth Development Fund (established 2009)	• Promotes active participation of the youth in the socio-economic development of the country. • Encourages unemployed youth to venture into sustainable and viable income-generating projects. • Reduces rural-urban migration by making it attractive to start business enterprises in rural areas.	Between 2009/10 and 2013/14, a total of 4 837 jobs have been created.
Botswana Innovation Hub (established 2008)	• Aims at developing and operating a science and technology park to aid in diversifying the economy. • Promotes research and development, education and innovation. • Supports start-ups and existing companies. • Attracts companies, universities, research institutes and advanced training institutes.	BIH has established a development programme which had 15 registered clients in 2014, that had created 25 jobs. Furthermore, over 200 technology start-ups have received mentoring and advisory guidelines.
Botswana Development Corporation (established 1970)	• Promotes and facilitates the economic development of Botswana. • Develops new and existing industrial, commercial, property and agricultural businesses and property development. • Provides direct financial investment or assistance, procurement of financial or management assistance and participation with persons, firms or companies – both locally and externally.	BDC has investments across 10 industries, including manufacturing, services, property and agriculture. The company has a balance sheet of over P3 billion and a portfolio of 41 clients and investments. Performance has been mixed with some successes in supporting companies (and in some instances ultimately divesting) in the finance, manufacturing, property development, tourism/hotels industries; but there has also been significant high profile losses of investment.

Source: Annual Reports, Websites of the Various Institutions and State of the Nation Address 2014 and 2015 swana, suggesting that the presence of BNPC and Government benchmarking arrangements with other countries (notably Singapore) have so far not yielded the desired results. However, the measurement of progress in this regard is hampered by inadequate data and information on productivity.

(d) Government Regulations and Their Impact on Employment Creation

4.17 The relevant government regulations relate to, among others, business operations (registration, licensing, etc.), land and building covenants, and labour and employment laws. Specific to employer-employee relationships, there is a view among the business community that the strict application of labour laws[29] can impede removal of non-performing personnel and result in costly delay in adjusting to changes in the business/economic environment. Restrictions (including delays and the cost of permits) relating to importation of labour and skills across all levels can also add to the cost of doing business and affect productivity and survival of enterprises.

4.18 The high level of unemployment suggests ample supply of labour, but the transition to employment could be affected by unwillingness to take up certain (lower level) jobs and a high reservation wage (associated with a generous system of social/family and income support); in the event, employing (skilled) foreigners willing to take up these jobs at the designated wages could be positive for economic activity and productivity. Moreover, a more accommodative work permit administration can help alleviate critical skills shortages and facilitate training of locals; conversely, a strict regime results in weaker business performance and discourages investment (or leads to disinvestment) in the local economy. A positive approach would be to view the ability to attract labour and capital as adding to economic prospects, which is ultimately beneficial in terms of the quality of products and services, as well as enhancing income earning opportunities for locals.

4.19 The other consideration is with respect to the minimum wage, which when set too high can result in a lower rate of hiring and preference for more capital-intensive operations or resorting to informal arrangements. The setting of minimum wages in Botswana has been circumspect and it does not appear that current levels have an adverse impact on hiring, as in practice employers pay above the minimum. Table 2.14 shows the annual rates of increase in minimum wages compared to inflation between 1980 and 2014. Evidently, the annual changes in minimum wages have lagged behind consumer price inflation for much of this period, to the extent that the real purchasing power of minimum wages has fallen significantly and thus appears to have posed at most a low risk to employment creation.

4.20 It has to be noted that there is some obligation on the part of employers to pay a decent wage and their costing and pricing of production and output should reflect this. Decent pay and working conditions help in employee motivation and productivity, while encouraging businesses to be efficient, with an overall positive contribution to economic activity. In some advanced countries, the minimum wage has been supplemented by the introduction of a so-called "living wage". However, use of a minimum wage as a means to address poverty and inequality is inherently problematic as wages are paid as a reward for the employee's contribution to business operations, while the standard of living is influenced by a wide range of factors, including household size and other forms of dependency.

(e) The Role of the Informal Sector and Small, Micro and Medium-sized Enterprises (SMMEs)[30]

4.21 SMMEs are globally considered to be a major

29 Including the Employment Act, Workers' Compensation Act, Trade Unions and Employers Organisations Act, Employment of Non-Citizens Act Cap 47:02 of 1983 and the Trade Disputes Act of 2003).

30 While the informal sector is often confused with micro-enterprises (often with synonymous usage), the two concepts are different. The World Bank defines a micro-enterprise as a business that employs less than five full time workers, but

Table 2.14: Increases in Minimum Wage Compared to Inflation

Period	Standard Minimum Wage[1]	Cumulative Inflation[2]	Change in Purchasing Power (Percent)
1981 -1990	155.6	171.0	-5.7
1991 - 2000	122.8	165.9	-16.2
2001 - 2010	85.4	126.6	-18.2
2011 - 2014	27.9	26.7	0.9
Whole period	**1 250.0**	**1 969.8**	**-34.8**

1. This is based on the minimum wage that is most commonly applicable across the economy in terms of sectoral coverage. While different levels may be applied in some sectors, the rates of increase are typically very similar.
2. Calculated using the rate of inflation prevailing in December each year.

Source: Bank of Botswana Annual Reports

source of entrepreneurship, industrial development as well as economic growth, and hence employment creation, and income earning opportunities, particularly for unskilled labour and undercapitalised entrepreneurs. Botswana's Industrial Development Policy of 1998 recognised SMMEs as important drivers of industrialisation and CEDA (2001) and LEA (2004) were thus established to directly address the challenges faced by SMMEs (Table 4.4). Recent government procurement strategies also target nurturing of the informal sector.[31] However, for SMMEs to realise their full potential as an engine of growth, it is important to create a favourable environment that allows them to expand and prosper. The informal sector is not always viewed favourably by governments, in part because it is not a substantial contributor to tax revenue. However, notably for Botswana, an informal sector survey conducted in 2015 estimated that the sector employed 191 176 people as of March 2015, thus constituting approximately 31 percent of total employment[32]. Nevertheless, the sector's contribution to Gross Domestic Product is modest, estimated at only 5.3 percent.

4.22 Overall, it is important to recognise the informal sector as contributing significantly to job creation and that, when properly run, some enterprises have the potential to graduate to formal sector status. In this respect, there are suggestions that the rigorous application of legislation and regulations[33] on business activity can be debilitating for the informal sector and undermine employment and income generation. A review of the framework for regulation could thus be warranted. Moreover, participants in the informal sector need to be involved in programmes for vocational and business training and other relevant skills development so as to enhance prospects for higher productivity and rate of growth.

(f) Impact of Government Policies on Competitiveness Rankings

4.23 The impact of the current regulatory environment on business operations and economic activity is reflected in the outcome of comparative studies on Ease of Doing Business, where Botswana ranks relatively poorly (Section 2) and in terms of comparative attractiveness of the country in relation to inward investment. The rankings suggest a need to remove impediments and work towards a more conducive operating environment. In general, as highlighted in Section 2, Botswana competes favourably on macroeconomic factors relating to fiscal, monetary

could be a formal business. However, to qualify as an informal sector business, the enterprise should neither pay tax nor be registered with the Registrar of Companies.

31 For example, government departments and parastatals are encouraged, in relevant areas, to source goods and services from SMMEs and, where feasible, afford them space and access to utilities to operate.

32 Informal Sector Report Version 5.2, 2015 by Ecosyst Consulting.

33 Examples include the Waste Management Act, Trade and Liquor Act and the Town Council Hawking and Street Vending Regulations.

and exchange rate policies.[34] However, there are microeconomic aspects on which Botswana is not doing well, such as perceived burdensome and restrictive labour regulations (for example, high redundancy costs and stringent hiring and firing requirements) and the time taken to complete registration and licensing of businesses. Related factors that are cited include inadequately educated workforce, poor work ethic and inefficient government bureaucracy. The relatively poor quality of infrastructure and inadequate access to finance are also cited as constraining productivity and competitiveness, thus economic activity broadly. These deficiencies will need to be addressed if a substantial improvement in the rankings is to be realised going forward.[35]

4.24 The Government responded to the 2011 Global Competitiveness Report, which saw Botswana decline in ranking to 80th position from 56th place three years earlier, by establishing the National Doing Business Committee (NDBC), which comprises government ministries and departments, parastatals, the private sector and labour unions; and the Cabinet Sub-Committee (Sub-Committee) on Doing Business. The NDBC is charged with improving Botswana's business climate. On the other hand, the Sub-Committee is mandated with monitoring and guiding the work of the NDBC and advising the Cabinet on necessary reforms on ease of doing business and global competitiveness. In this regard, Government approved the Doing Business Reforms Roadmap and Action Plan in 2015. Partly as a result of these initiatives, Botswana's rankings improved as highlighted in Section 2.

34 The regular independent assessments including those of the World Economic Forum, International Monetary Fund and sovereign credit rating agencies, highlight policy stability as reflected in government budget balance, relatively stable inflation, ample gross national savings, modest government debt, absence of foreign exchange controls, non-complexity of tax regulations and low tax rates.

35 The 2014 Industrial Development Policy for Botswana notes that high level Competitiveness Committees consisting of the National Doing Business Committee, made up of Government Ministries, parastatals, the private sector and labour unions, and the Cabinet Sub-Committee on Doing Business have been formed to deal with Botswana's global competitiveness shortcomings.

5. INFRASTRUCTURE, UTILITIES AND PRODUCTIVITY

5.1 The importance of efficient provision of public infrastructure and utilities to support competitiveness and productivity has already been emphasised in Section 2. For Botswana, the need for high-quality public infrastructure should be understood in the context of a sparsely populated, landlocked country, where recent signs of weakening in the economy add to the challenge of effectively combining an ambitious development agenda with a more equitable distribution of resources. Table 2.15 shows the performance of Botswana in the infrastructure category of the GCI since 2007 that reveals a trend decline overall, where the ranking has fallen from 46 to 83, and in almost all categories. The only significant improvement is in mobile phone coverage, where the country was ranked eighth globally in the most recent survey. However, not all categories are equally important for all countries, while recent improvements (major investment in airports, etc.) may not yet be taken into account. On the other hand, the GCI does not include water related infrastructure, where Botswana has recently experienced major challenges and resulting rationing of water across the country. Overall, the relative underperformance with respect to infrastructure needs to be reversed.

Infrastructure Challenges

Roads and Other Transport Infrastructure

5.2 Since independence in 1966, Botswana has steadily built up a substantial and generally well-maintained national road network. Recently, this has been with the support of the World Bank through technical assistance and financing provided as part of the Integrated Transport Project (ITP) for Botswana, with a total estimated value of USD385 million.[36]

36 The ITP aims to enhance the efficiency of the transport system by building modern business management capacity, and improving strategic planning of inter-regional transport and critical transport infrastructure. The three components to the project include: (i) technical advisory services to undertake a number of pre-investment activities and capacity-building; (ii)

Table 2.15: GCI Infrastructure Rankings for Botswana 2007/08 to 2015/16

	2007-08 (131[a])	2011-12 (142)	2015-16 (140)
Quality of overall infrastructure	46	57	83
Quality of roads	47	53	71
Quality of railway infrastructure	43	55	54
Quality of ports infrastructure	57	86	118
Quality of air transport infrastructure	94	93	103
Available airline seats	127	139	133
Quality of electricity supply	54	101	119
Mobile telephone subscriptions	***	45	8
Fixed telephone lines	93	105	89

a Number of countries in each survey shown in brackets

Source: World Economic Forum

Among others, the Trans-Kalahari Highway and commencement of work on the Kazungula Bridge, demonstrates the country's commitment to becoming a regional transport hub.[37] This will clearly support regional access and competitiveness of Botswana businesses, which rely on efficient transport links, both internally and externally, to access inputs for production and export markets. In this respect, there are three major considerations for development of road transport in Botswana.

5.3 First, the national road network continues to be put under strain by rapid growth in traffic volumes. This is clearly seen in the growth of vehicles registered in the country; an annual average rate of 8.9 percent between 2001 and 2014 with the number increasing from 120 000 to 426 000 (these figures exclude international traffic).[38] Thus, concerns about traffic congestion and inadequate maintenance of road infrastructure have become common in the main cities. In turn, this raises issues about sustainable financing for road construction and maintenance, including priorities for new road construction, the possible establishment of a dedicated fund to support maintenance, and introduction of direct user charges beyond the current system of licence fees and fuel-based levies.

5.4 Second, provision of road transport (and other) infrastructure to rural areas is key to unlocking economic potential and productivity of a larger part of the country, including the development of agriculture, eco-tourism, etc. At the same time, this must be set against the costs of providing such infrastructure, which are likely to be high, and the need to balance the economic factors with purely social considerations.

5.5 Third, the construction and maintenance of a national road network is not by itself enough for competitiveness. The other relevant factors relate to administrative efficiency (effective road licensing, traffic control to reduce congestion, improved road safety,[39] cross-border clearance procedures) as explicitly recognised in the ITP.

5.6 Similar issues apply to other forms of transport.

introducing a pilot long term output and performance based road contracting (OPRC) method for a road asset management programme covering some 800km of rural and semi-urban roads; (iii) implementation of an urban traffic improvement programme in greater Gaborone to address problems of congestion by introducing modern and advanced planning, design and implementation techniques.

37 The Trans-Kalahari Highway provides paved road between the port of Walvis Bay in Namibia, through Botswana, to Gauteng, the economic centre of South Africa. In turn, the Maputo Corridor extends this route from Gauteng to Mozambique, while it is also envisaged that a rail link between Botswana and Namibia will also be developed. The Kazungula Bridge will improve the efficiency of transport from South Africa, through Botswana to other countries in southern, central and eastern Africa. In 2014, 85 percent of passengers (including tourists and haulage operators) using the current ferry crossing at Kazungula were foreigners.

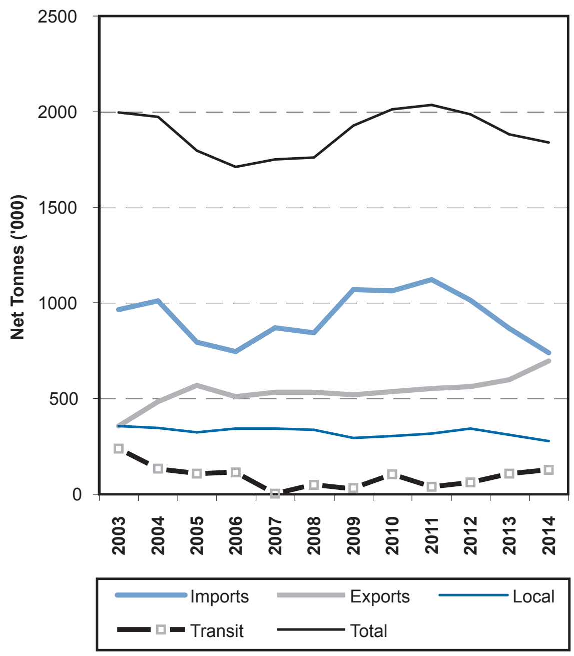
38 Within this total, registrations of passenger vehicles grew by 12.4 percent per annum.

39 This includes ensuring the effective operation of public transport systems.

For air transport (in the same period), total passenger movements have risen much more slowly, by 0.8 percent per annum. However, this is in large part due to a fall in the number of domestic passenger movements, which declined at an average rate of 2.3 percent; in contrast international passenger movements increased at an annual rate of 4.1 percent. At the same time, the slow growth rate may also reflect the limited number of available airline seats, where the country performs poorly in terms of the GCI rankings, and inconvenient schedules (for both international and domestic flights). Inefficient air transport can clearly be detrimental to both productivity[40] and job creation, especially in the tourism sector. The Government has responded with a series of initiatives to address these challenges, including investment in airports and recent entry of other airlines has improved access to international connections.[41] Nonetheless, it remains important to maximise the efficiency of service provision, including through the operation of the Civil Aviation Authority of Botswana.

5.7 As shown in Chart 2.6, the volume of goods carried by railways in Botswana has been stagnant in recent years, with modest growth in exports (mainly beef and mineral products) offset by declines in other categories. Given the limited reach of the national rail network that covers only a small (albeit the most populated) part of the country, this may not be a surprise; accordingly, rail transport contributes only a small fraction of GDP compared to road and air transport. Nonetheless, the fall in volumes of both imports and transit traffic are disappointing given the various initiatives that have been undertaken to develop rail as an alternative transport mode, and the country's decline in terms of the GCI ranking may also be a reflection of this.

CHART 2.6: RAIL GOODS TRAFFIC, 2003 - 2014



Note: Net tonnes refers to the weight of the freight carried.

Source: Statistics Botswana

5.8 The potential for rail transport as a driver for future development, including unlocking the value of mineral resources other than diamonds, should not be underestimated. The incorporation of a new rail link as part of the Kazungula Bridge development should also boost the status of the country as a regional transport hub. New external routes through Namibia and Mozambique have also been under consideration for some time, while enhanced links with the South African network also provides the advantage of lower development costs. Any such developments must necessarily involve a major role for the Government, given the long-term nature and cost of the requisite infrastructure together with the need for effective consultation and cooperation with neighbouring countries. However, this will need to be aligned with private sector expertise to achieve the necessary efficiency in both infrastructure investment and subsequent operation.

40 This is especially the case for higher management levels that, in turn, can impact on overall business productivity. For example, the lack of convenient flight connections was seen as a potential obstacle to the successful transfer of De Beers' diamond sales operations from London to Gaborone, and could be an impediment to more investors choosing Botswana for locating regional operations.

41 Air Botswana has also recently realigned its domestic flight schedules to be better aligned to preferences of potential customers.

Electricity and Water Supply

5.9 Lack of reliable supplies of electricity is a major constraint on both economic growth and, more broadly, human development and poverty alleviation, with many countries in Africa significantly disadvantaged in this regard.[42] The problems Botswana has faced with regard to inadequate power supply mainly relate to the Morupule B power station together with concurrent shortages in South Africa, the main source of power imports. However, compared to other countries in Africa, access to power in the country is relatively good (Table 2.16), as Botswana ranks relatively better in terms of both overall access and in provision of services to rural areas; nor is the price of electricity in Botswana notably high, either in the region or globally (Chart 2.7). However, the impact of disruptions is clearly indicated in the much poorer performance in the GCI rankings: although access levels are much lower in Namibia (and prices are considerably higher), that country still has a much higher GCI ranking (52 in 2015/16).

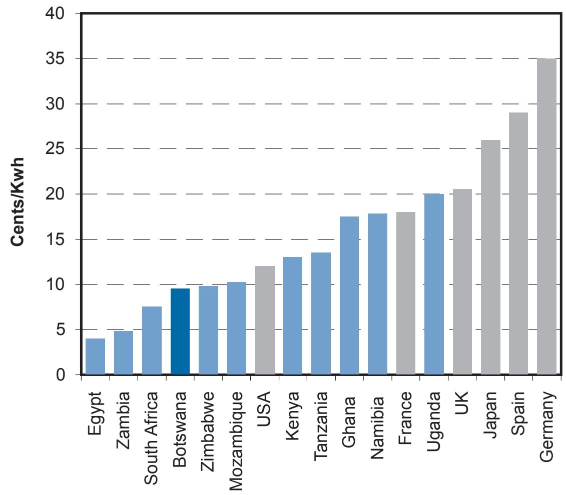
5.10 The recent challenges have also caused major financial difficulties for the Botswana Power Corporation (BPC), the state-owned utility responsible for both generation and distribution of power. In turn, this has drawn the Government into providing extensive subsidies to cushion the need for price increases (although these have not been avoided completely), especially for households. However, this is a heavy burden on the Government budget while also running counter to the Corporation's statutory mandate.[43] Nevertheless, the Government has ambitious plans to turn around the power sector in the coming years, moving rapidly to a position of net power exporter, including emphasis on renewable energy sources, solar power in particular.

Table 2.16: Access to Electricity (Percent)

	Overall	Urban	Rural
Transition economies & OECD	100	100	100
Developing Asia	83	95	74
Sub-Saharan Africa	32	59	16
Mauritius	100	100	100
Botswana	66	75	51
Namibia	30	50	17
South Africa	85	88	82

Source: World Energy Outlook 2014

Chart 2.7: Electricity Tariffs – Selected Countries, 2014



Source: Respective Utilities

5.11 Although not covered in the GCI, access to water also has a major impact on economic growth and development. In terms of basic indicators, Botswana ranks relatively highly, both globally and within Sub-Saharan Africa in terms of providing quality access to water to most of the population.[44] Nonetheless, recent acute disruptions have led to sustained rationing and the resulting negative impact on both households and businesses. As a drought-

42 See, for example "Power, People, Planet", the 2015 report from the African Progress Panel. The World Bank has estimated the total costs of insufficient access to power amount to 2 – 4 percent of GDP. Development of manufacturing is particularly constrained, while poorer households are also badly affected, being more reliant on less efficient and more unhealthy sources of energy.

43 The Botswana Power Corporation Act (CAP 74:01) requires it to be run on "sound commercial lines", including charging tariffs to ensure a reasonable return on its assets.

44 As of 2010, 96 percent of the population had access to improved water sources, of which 66 percent was through piped water, while only 3 percent were at risk from water scarcity. For urban areas, access to improved water supply was nearly universal at 99 percent (see UNICEF "Progress on Drinking Water and Sanitation - 2012 Update").

prone country, with limited access to perennial sources of supply and few suitable sites for dam construction, Botswana has always been vulnerable to water shortages. However, the recent shortages go beyond scarcity of supply (as plentiful reserves of water are available in the country as a whole) and reflect the cumulative impact of various policy choices relating to the provision of necessary infrastructure and effective distribution. Perhaps more fundamentally, the need to price water at levels reflecting its scarcity is crucial in relation to promoting productivity and competitiveness. In the absence of appropriate pricing, there is little incentive to minimise waste by either users or provider, while investment in water saving technologies remains underfunded. Effective demand management also needs to be considered when evaluating other policy interventions that may encourage development of sectors where output is water intensive, such as irrigated agriculture. There is also a need for intensified public education to gain greater acceptance for wider use of water-recycling technologies.[45]

Mobile Phones

5.12 The high ranking for access to mobile telephones present a different type of challenge: that of making the most of an opportunity that has potential to be a major driver of productivity and inclusive growth. There are two dimensions; first, is the need to make the most of opportunities for financial inclusion arising from the high levels of teledensity. By way of comparison, Kenya and other countries in East Africa are regarded as global leaders in the provision of mobile money, by relying on cell-phone technology, but are ranked far lower than Botswana on mobile teledensity in the GCI.[46] Mobile money provision in Botswana has been growing rapidly from a low base, but there appears to be further room for development.

5.13 The second challenge is to replicate the success in providing mobile phone access to other more advanced areas of ICT, such as the internet. According to the International Telecommunications Union, only 18.5 percent of people in Botswana used the internet in 2013 (resulting in a rank of 105 in the GCI). This is despite 49.5 percent having access to mobile broadband connections through their cell-phones, suggesting that the cost of access (which remains high by international standards[47]), together with lack of education about available facilities and benefits of internet usage, could be major barriers.

Access to Land and Related Developments

5.14 As emphasised in the 2015 State of the Nation Address, "the equitable and efficient distribution of land is a critical factor for realising economic opportunities and social well-being". However, in practice, allocation has been beset by inefficiencies that impact on both business operations and the inclusiveness of growth as many households remain frustrated by lack of access to land.

5.15 Problems related to land ownership are common in many countries, often typically aggravated by resistance to reform by those who benefit from restrictions and keep land prices artificially high. In Botswana, the system is based on the right of every citizen to be allocated land, for residential or business purposes, through a process based on queuing rather than price. There are also distinct urban and rural dimensions, one symptom of which is the relatively slower growth of urban populations

45 The need for more effective demand management was recognised in the 2006 review of the National Water Master Plan. Some progress has been made in this regard, as indicated by reduced per capita consumption. However, the extent to which significant wastage still occurs has been emphasised in the physical use and supply accounts of water usage in the country prepared as part of a project sponsored by the World Bank to develop environmental satellite accounts for the country (http://www.wavespartnership.org/sites/waves/files/images/Policy%20Brief_Botswana%20water.pdf).

46 In the 2015/16 GCI, Kenya is ranked only 122 for mobile phone penetration.

47 Although such comparisons are not straightforward, according to one international comparison, internet costs in Botswana were the fifth highest in the world as of November 2015 (http://www.numbeo.com/cost-of-living/country_price_rankings?itemId=33).

compared to adjacent villages, where access to land, despite controls supposedly in place, is easier in practice.[48] This has implications in terms of productivity, for which the efficiency of urban development can be an important determinant (see Section 2). Moreover, it can lead to social tensions as local inhabitants of the surrounding areas become marginalised, and these in turn can result in pressure to impose additional restrictions.

5.16 To help address this challenge, the Government plans to initiate an accelerated programme of land servicing to cover 37 000 plots (including residential, commercial, industrial and other). This will be facilitated by the establishment of a new land information centre that has been under development with the assistance of the Swedish Government.

5.17 However, for the full benefits of this programme to be realised, it has to be implemented efficiently and in a transparent manner and also as part of comprehensive land reform. The current system inevitably leads to under or sub-standard development and speculation (including artificial shortages and price escalation). An alternative could be facilitating access and land development by those who are best placed to do so, thus providing more opportunities for timely property developments, on-selling and renting at affordable levels and, therefore, fostering improved access to land and developed property across all income levels and for various uses. Overly-restrictive planning requirements (especially for small-scale developments) can also impede productive land development, while concerns that land will remain undeveloped can be addressed through appropriate tax measures rather than development covenants.[49] There is also a need to reform ownership structures (especially outside urban areas) to facilitate land to be used, as a matter of course, as security required for borrowing. Ultimately, a largely free market for land in Botswana will be in the interests of all parties, helping to meet local demand and address the challenge of providing affordable housing and in line with the objective of establishing the country as an attractive destination for foreign investors.

Framework for Provision of Infrastructure and Utilities

5.18 Key to any discussion of the provision of infrastructure and utilities is the question of the appropriate degree of Government participation, including ownership; or alternatively, the extent to which the private sector should be involved in the supply of what continues to be widely regarded as "public goods", where commercial considerations are not the only or even major concern. This is most obviously relevant in the case of utilities, but can also apply to infrastructure more generally, including options, such as funding alternatives that fall short of full privatisation.

5.19 The justification for state-owned enterprises based on them being "natural monopolies" for which public ownership is the most rational mode of operation is largely out-dated, now that it is possible to introduce a significant degree of competition in almost all markets. Nonetheless, certain industries might legitimately be regarded as sufficiently "strategic" given the importance of what they produce for other industries; and, in such cases, there may be a case for a degree of public ownership or control and/or oversight.

5.20 Historically, in Botswana, the case for establishing parastatals to provide basic utilities and other services was driven to a large extent by the absence of credible alternative providers. However, this was in the context of a very limited private sector operating in an environment of a low-income, sparsely-populated

48 Between 2001 and 2011 the population of Gaborone and Francistown grew by 2 percent and 1.9 percent per annum, respectively. In contrast, the population of adjacent villages grew by 5.3 percent and 3.9 percent per annum, respectively. In most instances, these villages are urban centres in all but name, but remain subject to different rules regarding land allocation. Importantly, the status of tribal land in providing security for bank loans is less clear cut than for urban land.

49 Local authority rates already provide scope for penalising lack of development; however, these are not always implemented efficiently.

country where commercial operations would not be viable, even for experienced operators. Moreover, public ownership remained the norm in many developing countries at the time, thus providing limited exposure to alternative models. However, this rationale for government ownership elsewhere and also in Botswana has diminished considerably in the context of the growth in terms of both size and capacity of the private sector, rising income levels, greater urbanisation and, not least, the growing breadth of global experience of successful privatisation to serve as a guide.

5.21 There are sensitivities surrounding the divestment of government assets, including the following:

(i) *Ownership*: resistance to privatisation often occurs on the basis that it could lead to ownership that is concentrated in few and/or foreign hands. However, there are advantages in having a strategic investor in terms of supporting operational efficiency, innovation and investment, and this can be combined with a divestment process that also allows for widespread ownership. Limiting foreign ownership runs the risk of impeding access to the skills, technologies and resources necessary for privatisation to be successful.[50] Ultimately, availability and access to infrastructure, utilities and service is what is key for the end-user rather than ownership.

(ii) *Employment, especially of unionised labour:* the association between privatisation and job losses is commonly made, but there is need for perspective in this regard. Retrenchments that may follow privatisation are usually indicative of the inefficiencies that accompany public ownership, while the resulting gains in productivity support job creation elsewhere or within the privatised entity offset the initial job losses.

(iii) *Pricing and investment policy*: the general concern is that moving operations to a more commercial basis will undermine the scope of pursuing "developmental" objectives and lead to unwarranted higher prices. Such objectives can, in many instances, be better served by mobilising resources through market-based incentives and, in this respect, a tendency for prices to rise following privatisation is, in many instances, the result of the previous suppression of prices below economic levels. Moreover, any need to maintain subsidies on a more explicit basis or to curtail excessive pricing as well as address developmental aspects can be dealt with through appropriate contractual and supervisory arrangements.[51] In addition, higher monopoly prices can be countered through allowing additional operators to enter the market.

5.22 Overall, the case for maintaining public ownership is easy to exaggerate, with the virtues overstated and the benefits of greater efficiency that almost invariably results from private operation largely ignored.[52] Despite the best intentions of governments, performance associated with public ownership is typically constrained by both bureaucratic inefficiencies and conflict-

50 This risk is likely to be significant in the context of service provision which has previously been undertaken by a state-owned monopoly, which almost inevitably limits the availability of domestic resources to take on its operation in a commercial context.

51 Once explicit and transparent, the benefit of subsidies can be more easily assessed. In addition, involvement of the private sector may promote the deployment of more efficient technologies that can support pricing structures that also take account of developmental and social objectives. Regarding excessive pricing, the interaction between regulators and private providers of telecommunications (such as in the European Union, for example) provide good examples of how such supervision can be effective in practice.

52 The difficulties that can arise from adherence to public ownership are amply demonstrated by the problems commonly associated with the attachment in many countries to maintaining a national airline. Not only can these be a drain on public resources (often in the form of subsidies to those with relatively high incomes), but the operational inefficiencies can undermine competitiveness, and hence the potential for job creation, of businesses (in the tourism sector, etc.) that rely heavily on the efficient provision of air transport services. In Botswana, another example is the Botswana Meat Commission (BMC) that in recent years has become a serious financial burden while its poor performance has arguably had a negative impact on the development of viable livestock sector in the country.

ing objectives that detract from the provision of quality services. In contrast, although not a panacea, using the private sector as a means to provide these services has the potential to unlock latent productivity and, hence, possibilities for job creation, both within the affected sector and across the economy.

5.23 This view is supported by the range of options, in terms of both a new ownership structure and the means of divestment, that are available, making it unlikely that retention of full public ownership needs to be mainlined due to the absence of any preferable alternative. That said, the reality remains that the Botswana market is small by any standards and the attractiveness of operating previously state-owned enterprises will be judged taking that into account by potential investors. Ultimately, whatever model is adopted for privatisation will almost inevitably require government to largely cede operational control which, in most cases, means relinquishing majority ownership, if the potential benefits are to be realised.

5.24 Regarding supervisory arrangements, the efficacy of, for instance, the Botswana Communications Regulatory Authority (BOCRA) in overseeing a sector with several commercially-oriented and mainly (but not only) private sector participants, provides considerable encouragement for such models to be extended. A possible option would be to revisit proposals to establish an independent regulator for other utilities so that prices for water and electricity are set at arms-length from the Government, even without the privatisation at this stage of either BPC or WUC. This is a model that is commonly used worldwide and, as noted, is compatible with both encouraging more commercial operations and the pursuit of other, more social-oriented objectives.

5.25 Despite previously slow progress, the fundamentals in favour of privatisation remain generally positive in Botswana. This is given the Government's capability to support parastatals' commercial reorientation, the increased capacity of the private sector and the broadly favourable rankings of the country as an investment destination. Moreover, the recent challenges regarding reliable provision of utilities have served to underline the limitations of continued reliance in public ownership. Thus, recent indications that the Government is actively considering allowing a greater role for the private sector in power generation are welcome. In turn, this could be extended to the other transport and utility parastatals facing their own challenges in terms of adequacy of infrastructure and providing respective services/utilities.

5.26 At the other end of the scale, opportunities for further outsourcing of public services (either those provided directly by the Government or through parastatals) and aspects of operations can be further explored. This is not only to reduce costs, but also for enhancing the quality of service delivery, including security of supply, through capacity of the private sector to innovate using modern technologies.[53]

Challenges for Public Infrastructure Provision

5.27 The scope for improving efficiency is evident in the extent of underspending of the government development budget that has been prevalent for many years. In this respect, important issues to consider include:

(i) *Identifying priorities for infrastructure provision*: the Government has a strong track record in effectively allocating funds to be spent under the development budget, which is primarily for infrastructure development. This has been further strengthened in recent years through renewed commitment[54] to a focus on high return investments. However, this process could be made more robust with more explicit reference to the criteria used to identify such investments, especially to the extent that they cover more socially-oriented interventions. This would

53 Thus far, service outsourcing has been mainly limited to labour-intensive activities, such as cleaning, gardening and security services. Possible opportunities for deploying private sector expertise at a higher level, including provision of ICT-related services and maintenance remain largely unexplored.

54 The annual Budget Speech and Budget Strategy Papers.

help underpin sustainable budgeting and, hence, the maintenance of macroeconomic stability, through the effective operation of appropriate fiscal rules.[55]

(ii) *Improved monitoring and evaluation*: although the allocation of funds through the development budget has resulted in the effective development of public infrastructure in Botswana, the returns on this investment have, in some instances, been eroded by less-than-satisfactory implementation and, subsequently, operation. Thus the recently announced decision to extend the mandate of the National Strategy Office to include monitoring of implementation is welcome, although this will need to be carefully coordinated with the budgeting process to ensure that adequate funding is made available.

(iii) *More active use of public-private partnerships (PPPs)*: as with the privatisation programme, the Government has proceeded cautiously with exploring opportunities to partner with the private sector in funding, project implementation and operation of public infrastructure. This is despite a comprehensive framework for the conduct of PPPs being approved in 2009. However, PPPs are not a panacea for resolving current challenges for infrastructure provision, while the Government's improved fiscal performance in recent years has understandably limited the attractiveness of more expensive funding sources. Nevertheless, the PPP approach remains relevant, especially perhaps for the larger projects that may exceed the Government's internal implementation capacity.

5.28 A further important issue is the extent to which effective infrastructure provision (and, more generally, Government procurement programmes) can be combined directly with the objective of employment creation. In Botswana, this is a major component of the EDD, while the development of infrastructure is also increasingly used for this purpose. However, significant challenges are also evident, including the risk of increasing further already high levels of dependency on Government (which, in turn, may limit the capacity of local businesses to improve their productivity), while also further burdening administrative capacity.[56]

6. BOTSWANA LABOUR MARKET, SKILLS CHALLENGES AND LESSONS FROM INTERNATIONAL EXPERIENCE

6.1 This section examines the challenges facing the labour market in Botswana, which together affect the structure of employment, the prospects for employment and earnings growth and how the Government labour policy evolves. As highlighted in Section 3, the unemployment rate in Botswana is high at around 20 percent, but lower than levels prevailing in other countries in the SACU region. Other countries in Africa record lower rates of unemployment, apparently due to widespread informal sector activity. For other countries which Botswana aspires to be compared with, the much lower unemployment rate (effectively full employment) reflects success with respect to economic diversification, skills development and effective government institutions and bureaucracy (for example Chile, Malaysia and Singapore). However, the profile (albeit significantly different rates) relating to generally higher youth and female unemployment is common, both regionally and globally. The persistently high unemployment rate in Botswana is in the context of a largely undiversified economy with a dominant public sector, notable skills gaps and a relatively smaller informal sector.

55 There is potential concern in this respect that the development budget in Botswana continues to include items that do not properly fall into this category, even if they are justifiable according to other criteria. For example, programmes of social support with recurrent implications, such as Ipelegeng or the subsidies currently provided to BPC, should not be treated as development spending.

56 This is already in evidence through concerns that contracts awarded to local businesses are not completed on time or to the required standard. The administrative burden will be increased further to the extent that further monitoring requirements are introduced, to cover employment targets and procurement practices, for example.

(a) Lack of Economic Diversification

6.2 Mining continues to be the largest single sector, accounting for about 25 percent of total GDP, but contributing approximately 3 percent of total employment. The small share of mining in total employment reflects its capital-intensive nature and, therefore, limited opportunities for employment creation in this sector. Moreover, despite the Government's concerted efforts to promote economic diversification, the share of manufacturing in total GDP has been modest at 5.7 percent and accounting for 5 percent of total employment in the same period.[57] At the same time, the performance of agriculture has been lacklustre, with a declining contribution to employment which, however, remains relatively high at 15.3 percent.[58] Indeed, much of the economy's employment opportunities are concentrated around agriculture, government, construction, trade and services (Table 2.17).

Table 2.17: Proportion of Total Employment by Economic Sector (Botswana)

Sector	Proportion of the Employed
Agriculture	15.3
Mining & Quarrying	2.9
Manufacturing	5.0
Electricity & Water	0.9
Construction	9.3
Wholesale & Retail Trade	13.6
Hotels & Restaurants	2.5
Transport & Communication	3.4
Finance	1.6
Real Estate	8.2
Central Government	10.9
Local Government	7.2
Education	7.8
Health	3.7
Other Community	2.7
Private Households	4.5
Foreign Mission	0.1
Not Stated	0.4

Source: Statistics Botswana (2011 Census)

6.3 The experience of other countries, such as Chile, Mauritius and Malaysia,[59] that have been successful in diversifying their economies away from exports of single commodities (such as minerals or agricultural products) to non-resource-based commodities, manufacturing products and/or services, indicates that these economies have broadened opportunities for employment across sectors and are more resilient to shocks (Table 2.18). Nevertheless, it appears that the structural changes are common for several economies, hence a declining share of agriculture in total employment and GDP, stagnant or decreasing share of industry (mining, manufacturing, water and electricity and construction) while that for the services sector is increasing.[60] As a result, increasing support to the services sector could be key to enhancing productivity and employment opportunities.

(b) Large Public Sector

6.4 The public sector plays a significant role in the economy of Botswana, and is an anchor for much of private economic activity, hence contributing to economic growth and employment creation (within the Government sector and through stimulating other economic activ-

57 The GDP figures for 2011 were used because they are consistent with the employment figures for the 2011 Population and Housing Census. On average, the contributions of mining, agriculture and manufacturing have respectively been 24.3 percent, 2.3 percent and 5.7 percent of total GDP in the past decade. Similarly, the latest 2015 shares of mining, agriculture and manufacturing in total GDP are 22.4 percent, 2.2 percent and 5.6 percent, respectively.

58 Indeed, most agricultural employment in Botswana is informal and subsistence. However, agriculture should still be viewed as the most immediate means for employment. In that respect, farming must shift rapidly from its present status as an occupation of last resort and low productivity, to one of technical dynamism and high productivity.

59 Chile was heavily dependent on copper exports and diversified into other non-resource commodities. However, it is acknowledged that there is still a strong need to achieve higher levels of diversification and sophistication in the Chilean economy as copper mining still contributes the largest share to both GDP and exports. Mauritius was dependent on the sugar industry and diversified into other sectors, notably tourism and export-oriented industries such as banking and finance and technology. Malaysia was dependent on tin and rubber and diversified into manufactured products (e.g., electronics and others).

60 The public sector dominates the services sector in Botswana. However, other services sectors such as wholesale and retail trade, hotels and restaurants, transport and communication and real estate are showing great potential for creating employment opportunities.

TABLE 2.18: PROPORTION OF TOTAL EMPLOYMENT BY ECONOMIC SECTOR IN BOTSWANA AND SELECTED COUNTRIES (PERCENT)

	Botswana	Malaysia	Mauritius	Namibia	Singapore	South Africa
Agriculture	15.3	12.6	7.0	29.8	…	5.6
Industry						
Mining	2.9	0.6	0.2	3.3	…	2.8
Manufacturing	5.0	17.6	18.5	5.6	11.9	11.2
Electricity & Water	0.9	1.1	1.0	0.5	…	0.9
Construction	9.3	9.1	10.1	7.2	4.7	8.9
Services						
Wholesale	13.6	16.6	14.0	7.3	16.5	19.9
Hotels	2.5	8.2	8.8	4.1	8.2	…
Transport & Communication	3.4	6.5	8.3	5.0	13.2	5.9
Finance	1.6	2.5	2.7	2.2	7.9	13.8
Real Estate	8.2	0.5	0.3	0.1	2.6	…
Public Administration	10.9	5.5	7.3	6.4	13.6	22.7
Local Government	7.2	…	…	…	…	…
Education	7.8	6.2	5.8	5.9	…	…
Health	3.7	3.3	3.5	3.1	5.1	…
Other	7.7	9.7	12.5	19.5	16.3	8.3

Source: Country Statistical Agencies

ity). The size of the public sector and related expenditure is largely supported by mineral revenue and is necessitated by the need to provide infrastructure, utilities and social services over a large and sparsely populated country on an equitable basis. As a result, Botswana has the highest central government wage bill relative to GDP (Table 2.19) compared to the best performing countries in terms of employment outcomes (i.e., Singapore and Malaysia). The relatively high wage bill reflects the fact that the Government's share of total employment in Botswana is comparatively high. In particular, general government (central and local) contributed about 13.8 percent of GDP in 2011 and approximately 18 percent to total employment.[61]

6.5 A 2013 World Bank report[62] postulates that a large public sector has the potential to crowd out private sector opportunities and lead to an inefficient allocation of human capital. Moreover, crowding out can occur in the education market when individuals seek qualifications appropriate for entering the public sector, rather than the skills needed for productive employment in the private sector.[63] Therefore, the dominant role of the public sector in the Botswana economy, albeit initially well intended and to some good effect, could have distorted labour market outcomes and diverted resources away from a potentially more dynamic private sector.

6.6 Through sound fiscal policy, Chile has managed to reduce the relative size of the government wage bill, while maintaining a structure of government spending that favours growth.[64] The reduction in the government wage bill in Chile was achieved through privatisation of activities that were deemed could be more efficiently undertaken within private markets and by decentralising central government activities. The experience of Chile, therefore,

61 Similarly, in 2013, the public sector, consisting of public service (central and local government) and public enterprises (parastatals), accounted for 52.5 percent of formal employment, while the private sector accounted for 47.5 percent.

62 World Bank (2013). "Jobs for Shared Prosperity: Time for Action in Middle East and North Africa". Washington DC: World Bank.

63 Salehi-Isfahani and Dhillon. (2008). "Stalled Youth Transitions in Middle East: A Framework for Policy Reform". The Middle East Youth Initiative Working Paper No. 8.

64 In 2011, the general government sector accounted for less than 5 percent of total GDP in Chile compared to almost 14 percent in Botswana.

Table 2.19: Central Government Wages and Salaries in Botswana and Selected Countries (Percent of GDP)

Country	2005	2010	2011	2012	2013
Botswana	10.5	10.7	10.6	10.8	10.6
Chile	3.7	4.2	4.1	4.2	4.3
Mauritius	6.1	5.8	5.5	5.4	6.1
Malaysia	4.7	5.9	5.7	6.4	6.2
Namibia	10.9	11.6	11.9	…	…
Singapore	3.3	3.1	2.9	2.9	3.0
South Africa	2.1	2.7	2.6	2.7	2.9

Source: IMF and Statistics Botswana

demonstrates that restraint in growing the public sector alongside devolution of an increasing share of economic activity to the private sector can support improvements in productivity, employment opportunities and long-term growth prospects. Indeed, restraining growth of the public sector could help reset expectations and realign incentives towards expansion of the private sector, which has the potential for innovation, adaptability and competitiveness that is crucial in the long-term for creating employment opportunities suitable for the new entrants to the labour market.

Table 2.20: Self-Employment in Botswana and Selected Countries (Percent of Total Employment)

Country	2010	2011
Botswana	15.6	18.6
Chile	26.5	26.6
Mauritius	20.0	19.0
Malaysia	25.7	23.4
Namibia	35.8	31.7
Singapore	14.5	15.0
South Africa	14.7	14.7

Source: World Bank and Statistics Botswana

(c) Small Informal Sector

6.7 The high unemployment rate in Botswana is also accompanied by a relatively low level of informal sector employment (highlighted in Section 4). Workers in Botswana have not responded to lack of wage-employment opportunities by engaging in widespread self-employment to the same extent as workers in other countries (Table 2.20). Possible barriers to informal sector employment and self-employment in Botswana could include lack of access to infrastructure and facilities/services, shortage of capital, insufficient skills/qualifications, low entrepreneurial drive and rigid trade and land use regulations.[65] A generous social and family support system could also reduce incentives to engage in informal income earning activity.

6.8 Evidence from other countries suggests that the informal sector can be a significant source of employment opportunities; this implies that there is need to accommodate growth of informal enterprises and recognise them as partners in development. In that respect, an enabling environment may include addressing some of the challenges emanating from lack of facilities/infrastructure for informal business; creating markets; and increasing access to vocational training, including financial literacy. There is also a need for a comprehensive informal sector policy that would balance the need for regulation with promoting economic activity and expansion of income earning opportunities.

65 For instance, in a paper titled "The Informal Sector Revisited: Botswana's Development State and Micro Enterprise Development", Menyah (2009) indicates that the Trade and Liquor Act, for which implementation responsibility lies with local authorities, is one of the unfriendly legislation that discourage the development of small scale enterprises. In particular, legislation requires a business to have a specific location of operation. However, most informal businesses lack access to land and operate in ungazetted areas due to shortage of business plots and high rentals.

Table 2.21: Public Spending on Education and School Enrolment Rate in Botswana and Selected Countries

Country	Public Expenditure on Education (Percent of GDP)	Enrolment Rate in Education		
		Primary	Secondary	Tertiary
Botswana	9.5	90.3	81.7	24.8
Chile	4.2	92.0	99.0	78.7
Malaysia	6.0	97.0	70.8	37.2
Mauritius	3.2	98.1	95.9	41.2
Namibia	8.3	87.7	64.8	9.3
Singapore	3.0	100.0	107.6	82.7
South Africa	5.2	89.6	110.8	19.7

Note: For primary education, the reported value corresponds to the ratio of children of official primary school age who are enrolled in primary school to the population of the corresponding official school age. For secondary and tertiary, the value corresponds to the ratio of total enrolment for the respective level, regardless of age, to the population of the age group that officially corresponds to the level of education.

Source: World Bank and the Global Competitiveness Report 2015/16

(d) Skills Mismatch and Quality of Education

6.9 The Botswana Government has spent heavily towards achieving universal basic education and increasing access at all levels (Table 2.21). However, enrolments rates in higher education, especially in tertiary institutions, remain low relative to comparator economies. This suggests that spending on education in Botswana has not been efficient, particularly compared to countries such as Chile, Mauritius and Singapore where spending relative to GDP is much lower, but they have higher enrolment rates.

6.10 Furthermore, despite some success in increasing enrolment rates, the quality and relevance of education in Botswana is being questioned. This is because of the generally persistent higher rates of unemployment and relatively low rate of self-employment, above 10 percent for all cohorts, among the country's trained labour force. The highest unemployment rates are recorded for junior and secondary school graduates (27.5 percent and 27.9 percent, respectively), followed by those with brigade certificate and diploma (23.5 percent and 19.8 percent, respectively), vocational certificate and diploma (17 percent and 13 percent, respectively) and university certificate and diploma (15.2 percent and 15.5 percent, respectively).[66] However, unemployment is lower for those with degree and science related qualifications such as nurses and those engaged in the education sector itself, such as teachers. Meanwhile, Chart 2.8 shows that Botswana has a lower proportion of tertiary students graduating in the fields of engineering, manufacturing, science and services compared to some of the selected countries, which could have implications for productivity and competitiveness of the economy.

6.11 Moreover, Table 2.22 indicates that while 16 percent of Botswana's labour force has a tertiary education qualification, only about 19 percent of those employed are considered to be skilled workers. Generally, these indicators do not compare well with some countries such as Singapore, which Botswana should aspire to match. Singapore's education policy has been one of the key factors underlining its economic success as indicated by the high percentage of

Table 2.22: Skills Deficit in Botswana and Selected Countries

Country	Percent of labour force with tertiary education	Percent of skilled employees
Botswana	16.0	19.1
Malaysia	23.4	28.0
Singapore	35.9	51.0

Source: Country Statistical Agencies

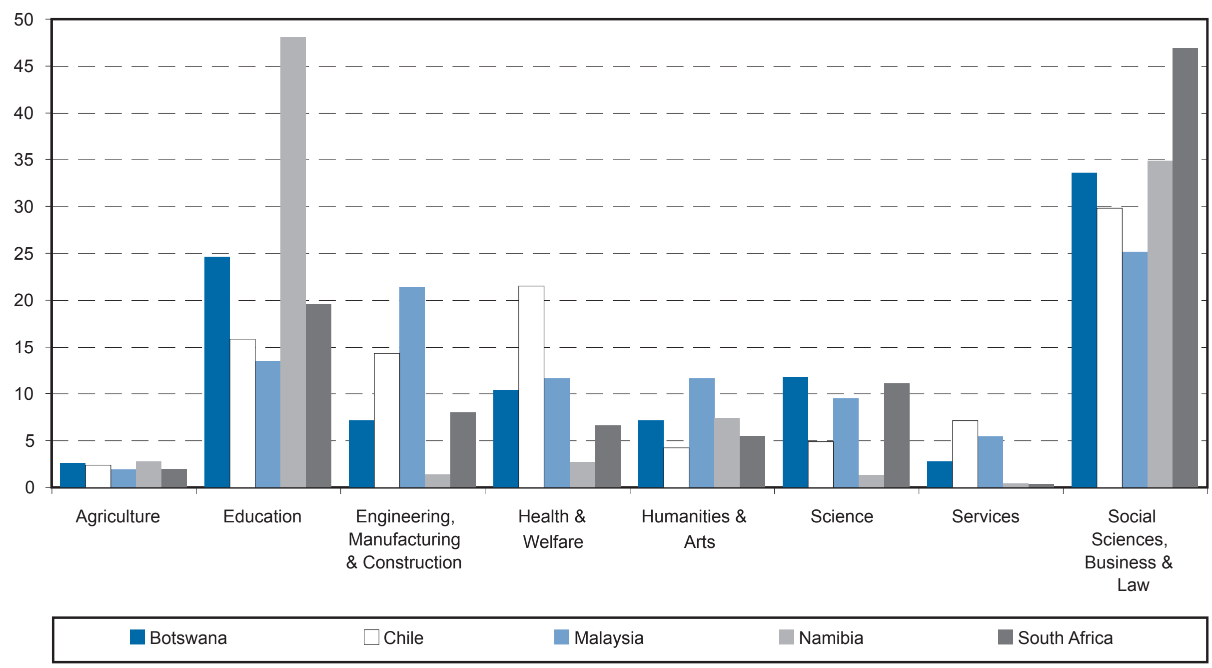
66 Statistics Botswana, Population and Housing Census 2011.

population with tertiary education and higher levels of skills and productivity.

6.12 It is apparent that relatively successful countries, such as Malaysia and Singapore, have over time effectively tackled the skills shortage problem commensurate with adjustment of their economic structure to engage in higher value-added activities. The quality of education in these countries has been enhanced through greater technical education and partnership with reputable international universities. The lessons from these countries point to clear areas

represents a different sort of challenge in terms of mismatches; i.e., the apparent unwillingness among local workers to accept more menial employment. The total number of work permit holders is small (about 2 percent of total formal employment in 2012). Thus, the suggestion that unemployment is somehow due to foreigners crowding out local labour is hard to justify. Even then, the evident decline in the number of permit holders could reflect a more restrictive administration, as echoed by business and industry, which is potentially detrimental to productivity and growth prospects.

Chart 2.8: Distribution of Tertiary Graduates by Programme of Study in Botswana and Selected Countries in 2013 (Percent)



Source: UNESCO

of policy development focus to improve the quality of secondary education and facilitate access to industry relevant and productivity enhancing tertiary education in order to increase prospects for employment and opportunities for earning higher income (including through self-employment).

6.13 With regards to employment of non-citizens (Table 2.23), the largest occupational category for work permit holders is "elementary occupations" (mainly agricultural labourers). This

6.14 Generally, for Botswana, there is need to reduce the gap between knowledge generated in the educational system and the skills demanded by employers and that are relevant for enhancing future growth prospects. In that respect, ongoing intervention to achieve continuous skills development and application to the job is necessary during the employment cycle; this should encompass on-the-job training and adaptation of new technology and systems to adjust skills to meet changing job demands and operating environment. Overall, addressing skills mis-

TABLE 2.23: TOTAL WORK PERMIT HOLDERS BY OCCUPATION

Occupation	2010	2011	2012
Managers/Administrators	1 417	1 214	839
Professionals	2 210	1 770	1 160
Technicians	1 739	1 755	1 170
Clerks	25	15	11
Service/Sales Workers	314	235	164
Skilled Agricultural Workers	16	9	7
Craft Workers	1 792	1 784	1 150
Plant & Machine Operators	870	638	462
Elementary Occupations	3 581	2 632	1 932
Not stated	2	2	2
Total	**11 966**	**10 054**	**6 897**

Source: Statistics Botswana (Work Permit Holders 2012)

match, the quality of education and the motivation/incentives for self-employment will be key to reducing unemployment in Botswana going forward. In this respect, the establishment of the Human Resources Development Council (HRDC), which aims to identify skills required for sectors with potential for employment creation, is a welcome development.

7. CONCLUSION

7. 1 Botswana's impressive track record of economic growth, averaging 6.3 percent per annum between 1981 and 2013, should ideally have been accompanied by meaningful employment creation and broad-based improvement in living standards. However, this review shows that job creation in Botswana has lagged far behind GDP growth, resulting in chronically high unemployment concentrated primarily among the youth. Even for those who do have jobs, low incomes and underemployment are serious problems. Quite simply, unemployment in Botswana has reached critical proportions, requiring a commensurate response from policymakers.

7.2 It is also important to bear in mind that, while economic growth in Botswana has thus far not been accompanied by adequate job creation, continuing to prioritise growth based on viable (i.e., profitable) business opportunities and development of human capital (involving key aspects such as job skills, entrepreneurship, productivity, adaptability and innovation) remains an essential pre-requisite for rising living standards. From this perspective, policies that focus on redistributing existing resources rather than generating additional employment opportunities are unlikely to have a lasting impact on job creation.

7.3 Key factors explaining the unemployment problem in Botswana are a relatively undiversified economy; a large public sector that may be crowding out the growth of the private sector; a labour force that is inadequately trained and has low motivation; a challenging business environment and regulatory framework that tends to limit growth and productivity of businesses; and a small informal sector, for which growth is constrained by, among others, lack of access to finance and rigid trade regulations. Notably, delays in registering a business in Botswana and difficulties encountered by employers in getting work permits for needed skilled labour, for example, should be resolved to facilitate (private) business growth. Ultimately, the objective of developing Botswana as a world class economy will only be realised in an environment which succeeds in attracting and retaining world class talent.

7.4 It should be recognised that factors contributing to high unemployment in Botswana are not new; indeed addressing problems relating to low productivity and lack of economic diversification have long been on the agenda, resulting in several policy interventions. However, as this review has pointed out, their impact has, in many instances, been limited, thus requiring reflection on why the anticipated results were not achieved. In particular, inadequate implementation appears to be a major cause of such underperformance, possibly indicating that scarce resources have been spread too thinly in the pursuit of multiple objectives or there has been insufficient commitment of resources to effectively implement initiatives. It is, nevertheless, crucial that the aforementioned problematic factors are focused upon and comprehensively addressed in order to alleviate the unemployment challenges and avert possible adverse economic and social consequences.

7.5 A large cohort of unemployed and underemployed people, comprising mostly the youth, represents a waste of valuable resources and needs to be addressed urgently, in order to realise the potential of the economy and maintain social cohesion. Specific interventions, including the Youth Development Fund and Young Farmers' Fund, that are intended to tackle the problem of youth unemployment are relevant in this regard. However, additional effort is required to improve the employment prospects of young people through aligning skills and training with job requirements, as envisaged by the creation of the HRDC, and removing barriers to the growth of small and informal businesses.

7.6 This review has also demonstrated, from a variety of perspectives, that low productivity growth in Botswana remains a key challenge that must be addressed if national ambitions regarding improved living standards, reduced inequality and incidence of poverty are to be realised. Factors impeding productivity are ineffective public administration, poor work ethic, inappropriate incentives (for example, untargeted subsidies for agriculture) and expensive and/or unreliable utilities. To address productivity shortfalls, the Government has put in place policy initiatives and institutions that include privatisation of state-owned enterprises and the establishment of the BNPC. However, there has seemingly been some reluctance to carry through privatisation initiatives; thus forgoing the potential for gains in productivity. Such inertia needs to be overcome, given that economy-wide gains in terms of growth and job creation from more efficient provision of key utilities should substantially outweigh any short-term costs, including job losses at the privatised entity. Likewise, BNPC has not made much progress, and is yet to translate awareness that productivity is major challenge into implementable programmes to address this deficiency. Unless this, too, is pursued with vigour, gains in expanded employment opportunities and standards of living will continue to elude Botswana.

7.7 Alongside low productivity, performance in terms of other factors that influence competitiveness has also been unsatisfactory, especially in comparison with other countries. Again, problematic factors include inefficient government bureaucracy, restrictive labour regulations, insufficient finance and inadequate supply of infrastructure. The measures in place to deal with loss of competitiveness include maintenance of appropriate macroeconomic policies (including the crawling band exchange rate mechanism) and initiatives under the industrialisation policy (among others, establishment of BITC and the planned introduction of SEZs). However, it is clear that, unless the abovementioned problematic factors are fundamentally addressed, Botswana will continue to struggle to compete with other countries that have successfully overcome similar hurdles. Furthermore, Botswana can increase its appeal as a competitive investment destination and overcome its small market size by committing more to regional integration than is presently the case. At the centre of Southern Africa, Botswana can benefit greatly from a thriving regional economy, but to realise this requires full and consistent commitment to opening the economy to competition and levels of productivity from elsewhere.

7.8 As a way to deal with the unemployment problem, there is need to continue engaging in structural reforms that can spur economic diversification and sustain non-mining output growth among sectors with more potential for job creation. Reforms are also needed to reduce the size of the public sector, relative to GDP, in line with the Government's expected revenue base and implementation capacity. In the short term, it may be appropriate to use government spending to boost the economy; but, in the end, the continued absorption of scarce resources by the public sector can be detrimental to growth prospects. There is also a need to guard against duplication of initiatives under different programmes and institutions. Ultimately, government resources should be focussed on the effective provision of "public goods", that is, goods and services that cannot be effectively provided by the private sector.

7.9 In line with this, effective provision of public infrastructure and utilities is essential. Thus, rapid growth in traffic volumes, lack of transport infrastructure to areas with economic potential, electricity and water supply disruptions and limited access to high speed internet compromise productivity improvements. To enhance efficiency in the provision of public infrastructure, it will be important to improve monitoring and evaluation, as well as encouraging partnership between the Government and the private sector in funding, project implementation and operation of public infrastructure and utilities. Closely related to public infrastructure, it is also essential that regulations governing access to land are subject to a critical review that recognises the extent to which traditional/historical means of allocation are detrimental to economic efficiency and supply of residential, industrial and commercial property. A focus on enabling effective and timely development of land and property to meet demand is potentially more productive than a queuing system.

7.10 At the other end of the scale, it is critical that the role of the informal sector and SMMEs be accorded priority in recognition of the capacity of small businesses to generate employment and a learning environment for entrepreneurship and business skills. In this respect, regulations that constrain the operations of the informal businesses need to be reviewed with a view to adopting a more permissive approach. Furthermore, skills gaps relevant to this segment of the labour market must be addressed, working in conjunction with the private sector, as must access to finance. At the same time, however, within this more accommodating environment, institutions that assist SMMEs, such as CEDA and LEA, need effective monitoring to avoid unproductive use of public resources.

7.11 Overall, Botswana should prioritise job creation, become more competitive and promote productivity improvements through providing relevant training and skills to address poor work ethic and by enhancing efficiency of government bureaucracy. There is also a need to look carefully at the framework for providing infrastructure and utilities, with a focus on benefit to the end-user rather than ownership. Working together, therefore, enhanced competitiveness, productivity improvements and job creation will result in sustainable economic growth and social cohesion.