



BOTSWANA

SELECTED ISSUES

August 2017

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BOTSWANA

SELECTED ISSUES

July 14, 2017

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FINANCIAL SECTOR STABILITY AND DEVELOPMENT

A. Background

1. The financial sector is open and relatively well developed, yet there seem to be too many commercial banks. As of end-2016, there were 11 commercial banks and 2 small state-owned statutory banks, with 4 banks holding about 80 percent of the banking system's assets (Table 1). However, there seems to be room for consolidation, considering Botswana's population of 2.1 million people. All commercial banks are foreign-owned, including subsidiaries of pan-African groups. There are also several nonbanks that account for about one-half of the financial system.

Table 1. Botswana Financial System Structure, 2016

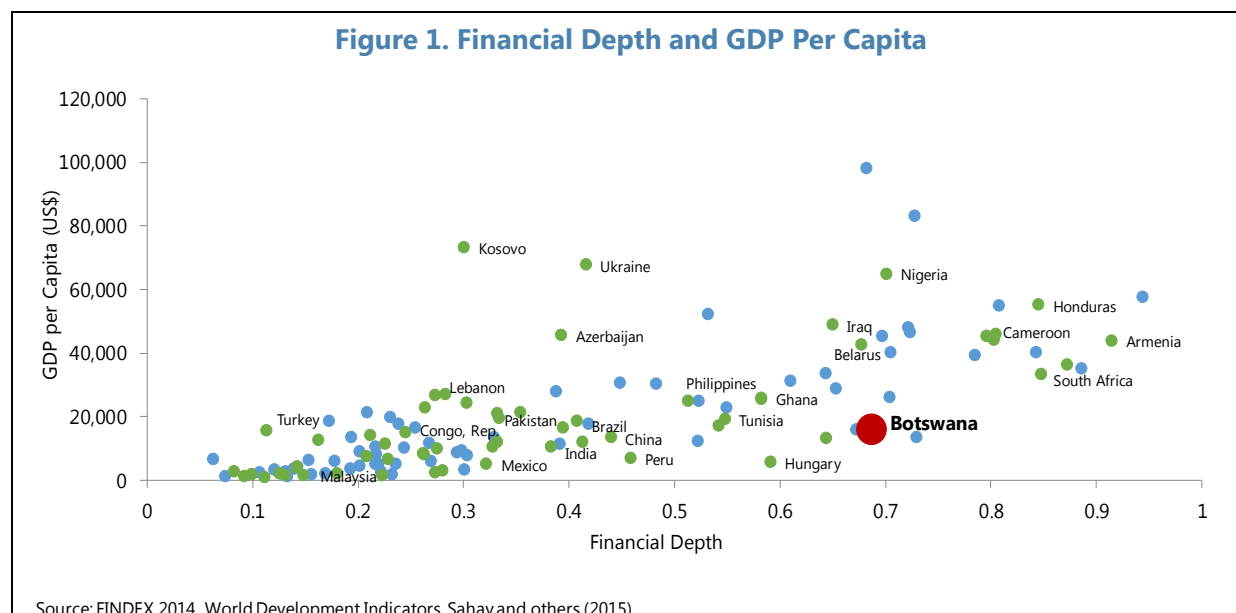
Institutions	Number	Assets	
		In billions of Pula	In percent of assets
Banks		88.4	43.4
Commercial banks	11	80.7	39.6
Statutory banks	2	3.9	1.9
Building Society	1	3.8	1.9
Non-bank financial institutions		115.0	56.6
Life Insurance	9	19.7	9.7
General Insurance	12	1.9	0.9
Reinsurers	3	0.3	0.1
Pension Funds	87	75.1	36.8
Asset Managers	12	5.5	2.6
Non-Bank Lenders	7	8.6	4.2
Micro Lenders	20	3.9	1.9
SACCOs	52	0.5	0.2
Total financial system		203.8	100

Source: Bob's Research Department and NBFIRA.

2. The financial system has grown rapidly over the years, but there is still substantial scope for expansion. Banks, institutional investors—in particular, the pension industry—and the Botswana Stock Exchange have grown steadily over the years based on political and economic stability, savings from diamond exports, and fiscal surpluses.¹ Between 2008 and 2016, pension fund assets grew from 30 percent of GDP to 47 percent of GDP, facilitating a rapid increase in bank

¹ Royalties, dividends, and taxes paid to the government from remitted diamond receipts are absorbed by the BoB, thus constituting the main source of liquidity flowing into the financial system through government expenditure disbursements.

deposits and in stock market capitalization (which almost doubled in this period). Similarly, Botswana's insurance premiums increased from 3 percent of GDP in 2005 to 13 percent of GDP in 2016, making per capita insurance contributions among the highest in Africa. Overall, the ratio of broad money (M2) to GDP rose rapidly from 10.6 percent in 2005 to 41.5 percent 2016. Despite this growth, there is still scope for further financial deepening (Figure 1).



B. Soundness

3. The banking sector remains adequately capitalized, liquid, and profitable. The latest financial soundness indicators (Figure 2) suggest that, benchmarked against comparators, the banking system is well-capitalized and with adequate levels of liquidity. Bank profitability rose owing to higher interest and non-interest income. Modest growth in personal incomes and high household debt ratios have prompted a more cautious approach to lending by commercial banks, leading to a slowdown in annual credit growth from 7.1 percent in 2015 to 6.2 percent in 2016. Non-performing loans rose slightly to 5.5 percent of total gross loans in March 2017 but remain manageable.

4. Risks to the financial system are contained. Banks rely on domestic funding sources and unsecured household lending is diversified, mitigating risks for an escalation of non-performing debts.² In addition, the country's large international reserves buffers, the ongoing recovery in the global diamond market, and high interest margins on credit imply that the economy and the financial sector will be able to cope with potential losses. Nonetheless, given the still large share of household credit in banks' loan books (60 percent at end-2016), continued monitoring of the system is warranted.

² Wholesale business deposits remained the main source of commercial banks' funding at 73 percent of total deposits in December 2016, sustaining the net debtor position of households. A significant share of banking loans is extended to the employees of the public sector or larger corporate and serviced through direct payroll deductions.

Figure 2. Comparative Indicators of Banking System Soundness¹



Source: IMF staff calculations.

1/ Data for latest year available. 2/ RWA abbreviation for risk-weighted assets.

C. Stability

5. Botswana financial stability framework could be usefully upgraded. Data gaps and incomplete information on cross-border capital flows and growing interconnectedness with the non-bank financial sector may entail potential risks. In this regard, close cooperation among regulators and a proper assessment of macro-financial risks associated with banks' large exposures will be important to improve the effectiveness of financial system supervision (including consolidated supervision).³ In addition, the authorities' plan to reform AML/CFT supervision and preventive measures in line with the recommendations of a recent assessment of the AML/CFT framework will help protect the financial sector against money laundering and terrorism financing risks.⁴

6. The authorities are proceeding with reforms to upgrade banking supervision. The BoB is planning to bring to completion the implementation of the Basel II framework by end-2017, including the adoption of Pillar 2 requirements, which address risks not adequately covered by Pillar 1 (i.e. concentration risk). Basel II capital standards were implemented in January 2016 and guidelines issued to the banks. The impact of this change is expected to be easily absorbed by the banks, with Pillar 2 of Basel II is planned to enter in force in 2018.⁵

7. Continued monitoring of banks and nonbanks remains important. Annual on-site supervisions for each institution deemed systemic will strengthen the risk-based approach adopted by the BoB. Given the exposure of banks and non-bank lenders to the household sector, consideration could be given to designing a dedicated stress test exercise aimed at assessing the impact of different shocks (lower income, higher unemployment, higher interest rates, etc.) on households' debt-servicing capacity. At the same time, it will be critical to improve capacity at the Nonbanks Financial Institutions Regulatory Authority (NBFIRA) to perform risk-based supervision on nonbank financial institutions, enhance data collection, and enable technological innovations in this subsector.

³ Currently, the BoB has regulatory and supervisory responsibility for commercial banks, exchange bureaus, and one deposit-taking microfinance institution, as well as for statutory banks and the payment system. The Nonbanks Financial Institutions Regulatory Authority supervises the nonbank financial institutions (the insurance industry, pension funds, stock exchange, fund managers, other investment advisory service providers, and micro-lending businesses).

⁴ Botswana's AML/CFT regime is not yet fully developed. The *Eastern and Southern Africa Anti-Money Laundering Group* prepared an evaluation in 2017 highlighting several shortcomings and providing recommendations to improve Botswana's level of compliance with the FATF standards and strengthen the effectiveness of the AML/CFT system.

⁵ Among non-bank financial institutions, there is a group of about ten quasi-bank lenders, providing unsecured consumer credit (relying on the use of deduction codes), which are currently subject to the same regulation as micro lenders. In addition, the savings and credit cooperatives (SACCOs), which accept deposits, are not subject to prudential regulation and neither of Botswana's two financial sector regulators—the BoB (which supervises banks), or the NBFIRA (which supervises non-banks)—supervises them.

D. Macroprudential Function

8. Creating a macro-prudential authority—with a prominent role for the Bank of Botswana—will further protect the system against potential systemic risks. To enhance the use of the macroprudential policy framework, the authorities need to assign a clear macroprudential mandate to one institution (e.g. the central bank) to establish macroprudential measures (e.g. limits on debt service-to-income ratios) for the whole financial sector in coordination with other supervisors and ensure the sharing of information among supervisory bodies to improve the analysis of systemic risks.⁶ Given the size of the banking system and its supervisory mandate, the BoB is uniquely placed to lead systemic risk assessment and mitigation by deploying macro-prudential tools. In addition, setting up a credit report database, strengthening its legislation, and establishing an on-line collateral registry for immovable and movable assets will help improve the system's depth, efficiency, and competitiveness as well as contribute to private sector growth.

9. At the same time, the crisis resolution framework could be strengthened. The authorities continue to enhance their financial crisis preparedness but a sufficient level of staffing is needed to ensure its capacity for timely action. Priority should be given to developing a framework and a contingency plan for responding to banking problems by revising the Bank of Botswana Act and the Banking Act.⁷ Key reforms also include accelerating the implementation of the Financial Stability Council and the Memorandum of Understanding among BOB, MFED, and NBFIRA regarding responsibilities for bank resolution, and entrusting the BoB with sufficient legal powers to resolve banks in distress.⁸

E. Development

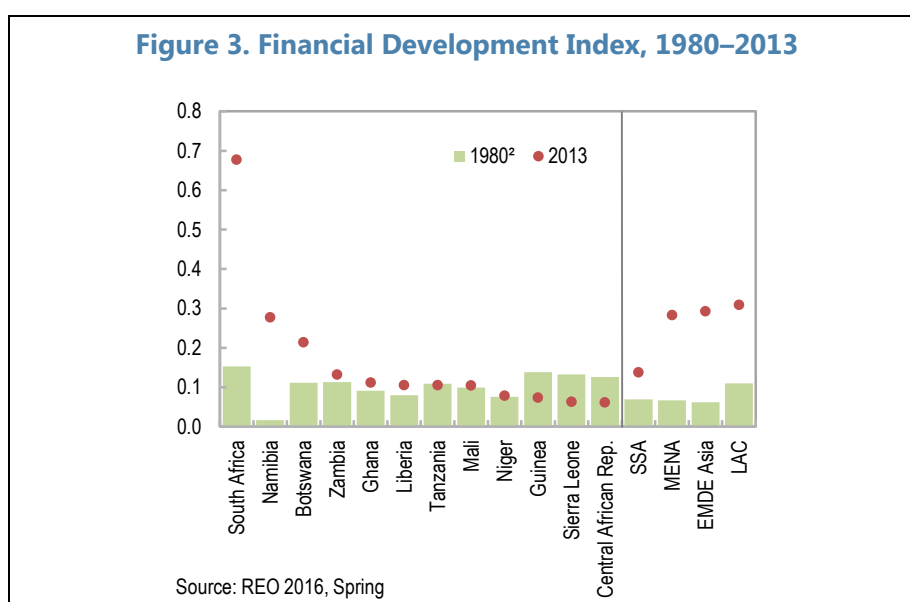
10. Financial institutions and markets in Botswana have developed rapidly since 2000, supported by the growth of both banks and nonbanks. Banks assets have expanded rapidly, together with those of other financial institutions—like the Botswana Stock Exchange and institutional investors (Figure 3, Regional Economic Outlook for sub-Saharan Africa, April 2016).

⁶ Coordination arrangements could be arranged for a close coordination between the BoB, the MFDP, and NBFIRA. In this regard, the establishment of an inter-agency Financial Stability Council could promote information exchange, cooperation and coordination on financial stability, supervision, and crisis resolution.

⁷ Major amendments are required to the legal framework. Revisions to the existing Bank of Botswana Act and Banking Act are needed to remedy the deficiencies in the emergency liquidity assistance capabilities, the corrective action framework, and bank resolution powers. The BoB has made substantial progress in drafting proposed amendments to both laws to address these deficiencies.

⁸ Effective resolution arrangements in the nonbank financial institutions sector as well as in payment and settlement systems could complement these efforts. The current powers are largely limited to the ability to issue directives to a bank, place a bank into temporary management, and apply to the court for the winding up of a bank or commencement of judicial management. The powers are not broad enough in scope to provide an effective legal framework for resolution.

11. Looking ahead, the authorities may try to develop a financial sector hub for the region. A financial hub could contribute to private sector development as it could adapt its services, regulation, and infrastructure to make investment by foreign investors easier and allow them to hedge risks, thus enabling capital to be efficiently channeled into investment projects.⁹ If the authorities conclude that such potential is worth pursuing, they could develop a strategy entailing: (i) measures to improve electronic connectivity, including having real time data from markets, order routing systems, and ability to clear and settle trades in foreign markets; (ii) the adoption of the Principles for Financial Market Infrastructures published by CPSS-IOSCO; (iii) a modernization of the national payments system by implementing the new Oversight Policy Framework and addressing gaps in the prudential and supervisory framework of non-banks financial institutions; and (iv) a strengthening of the clearing house to facilitate risk management in derivatives, net offsetting positions, and collection of collateral in the event of defaults.

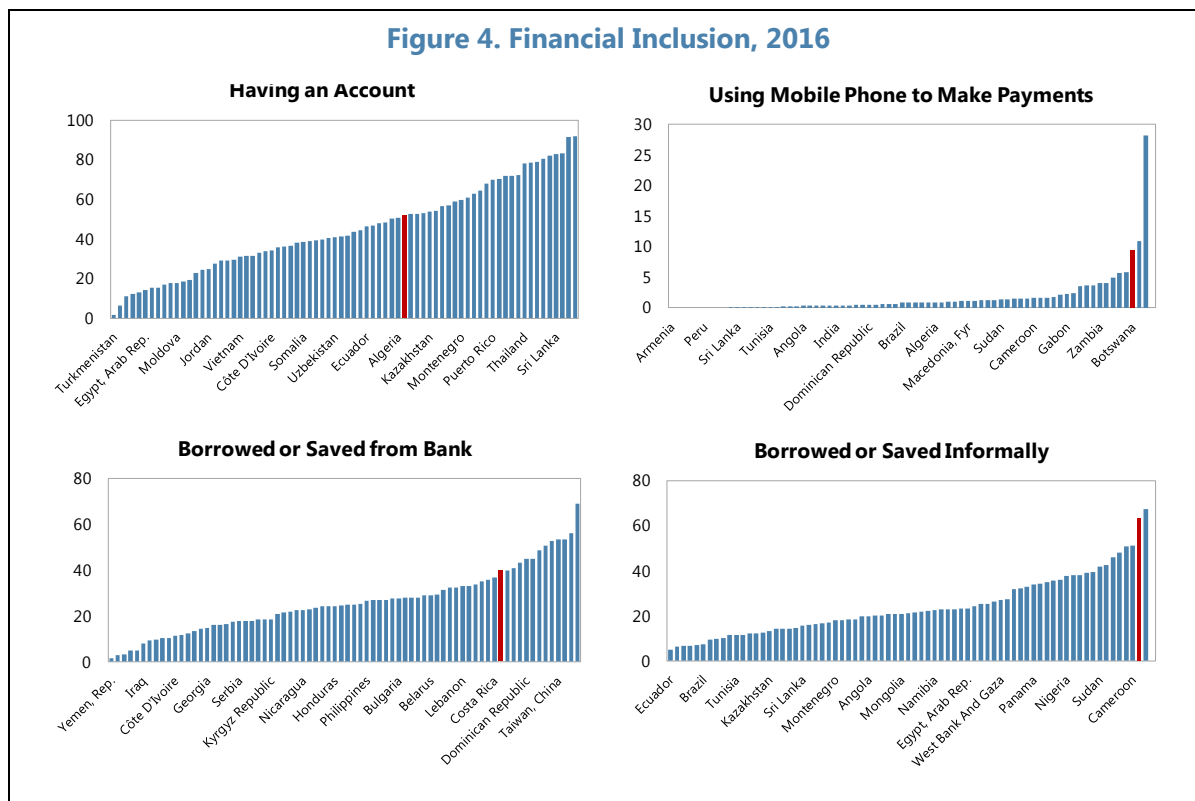


12. Lastly, Botswana is performing relatively well regarding access to finance and use of mobile banking but there is scope for further progress (Figure 4). In this regard, implementing the recommendations of the Botswana Financial Inclusion Roadmap—Making Access Possible Plan (MAP) prepared in 2015 and coordinating supervisory efforts between BoB and NBFIRA will help extend services to small and medium enterprises and into underserved areas, improving access to finance and real sector activity.¹⁰ In addition, financial inclusion can benefit through improvements in

⁹ A wider investor base leads to deeper market liquidity. On the one hand, the financial center with the best expertise, connections, and liquidity in the region becomes the natural gateway for investment in other countries in the region. On the other hand, the existence of a well-developed financial hub becomes an attractive location for any major international financial institution to set up a branch or subsidiary from which to distribute products and services to clients across the region.

¹⁰ The MAP is a multi-country initiative to support financial inclusion through a process of evidence-based country diagnostic and stakeholder dialogue. Its goal is to develop national financial inclusion by identifying key drivers of financial inclusion, strengthening domestic development dialogue on financial inclusion, and engaging international platforms and entities impacting on financial inclusion.

the payments system, setting up credit bureaus, and adopting a sound regulatory framework for mobile money.



F. Summary

13. Botswana’s financial system has evolved rapidly in recent years. Near-term risks are small due to a well-capitalized and liquid banking system and sizable international reserves. The authorities plan to undertake important actions to strengthen the system’s soundness in the areas of financial supervision, crisis resolution, and AML/CFT. While access to finance is higher than in other sub-Saharan African countries, a number of reforms can usefully be implemented to foster financial deepening and financial inclusion and complement efforts to promote the expansion of the private sector and employment creation.

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- Sahay, Ratna, Martin Čihák, Papa N’Diaye, Adolfo Barajas, Srobona Mitra, Annette Kyobe, Yen Nian Mooi, and Seyed Reza Yousefi, 2015, *Financial Inclusion: Can It Meet Multiple Macroeconomic Goals?* 2015, IMF Staff Discussion Note.

REFORMS TO MOBILIZE DOMESTIC REVENUES

A. Background

1. Botswana has the second lowest tax to GDP ratio among Southern African Customs Union (SACU) members (Table 1). The same is true regarding its taxation of income and taxation of goods and services (Table 2). Moreover, the value-added tax (VAT), the corporate income tax (CIT) standard rates, and the personal income tax (PIT) top marginal rate are the lowest in the customs union (Table 3).

Table 1. SACU Members—Tax to GDP Ratios

Country	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Average
Botswana	25.0	27.5	25.6	21.3	23.4	25.9	24.9	26.3	25.7	23.8	24.9
Lesotho	53.9	56.5	55.1	37.2	38.2	53.4	51.0	53.0	50.3	40.3	48.9
Namibia	28.6	28.8	28.4	25.5	27.2	29.3	29.7	31.7	32.1	29.0	29.0
South Africa	24.9	24.6	23.0	23.0	23.2	23.3	23.5	23.9	24.8	25.4	24.0
Swaziland	31.1	32.8	28.1	19.1	19.0	28.6	27.6	28.2	26.7	23.0	26.4

Source: WEO.

Note: Tax Revenue does not include Social Contributions.

Table 2. SACU Members—Comparison of Revenues
(percentage of GDP)

Country	Year	Taxes on Income	Taxes on Goods and Services			Taxes on International Trade		
			VAT	Excises	Total	Imports	Exports	Total
Botswana	2014	11.08	3.99	0.00	3.99	10.95	0.00	10.95
Lesotho	2013	14.32	8.73	1.02	9.75	0.00	1.33	1.33
Namibia	2015	12.38	7.71	0.15	7.89	No Data	No Data	No Data
South Africa	2015	15.12	7.00	2.32	9.32	1.12	0.00	1.13
Swaziland	2012	5.23	3.93	0.00	3.93	17.12	0.00	17.12

Sources: for revenues, WEO (total tax revenue) and GFS (remaining revenue data); for GDP, WEO.

Notes: a) Tax revenue does not include Social Contributions; b) "No Data" fields represent missing values.

Table 3. SACU Members—Comparison of Tax Rates

Country	VAT standard rate	CIT standard rate	PIT highest marginal rate
Botswana	12	22	25
Lesotho	14	25	30
Namibia	15	32	37
South Africa	14	28	45
Swaziland	14	28	33

Source: IBFD

2. Government revenue is heavily dependent on mineral revenue and revenue from the SACU sharing pool. The non-mineral tax revenue-to-GDP ratio has been around 20 percent since

fiscal year 2010/2011 except in 2012/13 (Table 4). In recent years, more than half of this share has come from the SACU pool. In other words, domestic revenue mobilization—essentially PIT, CIT, and VAT revenues—has fallen to less than 10 percent of GDP. Moreover, SACU revenue plus mineral revenue (taxes, royalties and dividends) has exceeded 63 percent of total government revenue during the past five years.

Table 4. Botswana: Government Revenues

Period ¹	Customs & excise	Income tax	Value-added tax	Other taxes					Sub-total	Non-mineral tax revenue	Mineral revenue ²	Other non-tax revenues	Total revenue
				Export duties	Property taxes	Vehicle taxes	Licence fees	Airport tax					
In million Pulas													
2008/09	7,750	4,608	4,377	2	26	191	28	21	268	17,003	10,182	3,270	30,455
2009/10	7,931	5,561	3,943	1	27	189	33	0	250	17,685	9,088	3,249	30,023
2010/11	6,207	6,413	4,638	2	35	229	33	0	298	17,556	12,060	2,294	31,909
2011/12	8,424	6,113	4,851	1	65	215	41	0	322	19,710	15,823	2,953	38,486
2012/13	14,216	6,725	5,283	2	51	224	29	0	306	26,530	12,076	3,052	41,658
2013/14	13,170	7,471	4,885	2	55	244	36	0	337	25,863	18,443	4,645	48,951
2014/15	15,691	8,384	5,710	2	54	250	33	0	338	30,123	21,532	4,249	55,904
2015/16	15,818	8,691	5,548	2	53	282	28	0	365	30,421	14,438	2,562	47,420
In percentage of GDP													
2008/09	10.4	6.2	5.9	0.0	0.0	0.3	0.0	0.0	0.4	22.9	13.7	4.4	40.9
2009/10	10.3	7.2	5.1	0.0	0.0	0.2	0.0	0.0	0.3	23.0	11.8	4.2	39.1
2010/11	6.8	7.0	5.1	0.0	0.0	0.3	0.0	0.0	0.3	19.2	13.2	2.5	34.9
2011/12	8.0	5.8	4.6	0.0	0.1	0.2	0.0	0.0	0.3	18.8	15.1	2.8	36.7
2012/13	12.7	6.0	4.7	0.0	0.0	0.2	0.0	0.0	0.3	23.6	10.8	2.7	37.1
2013/14	10.0	5.7	3.7	0.0	0.0	0.2	0.0	0.0	0.3	19.7	14.1	3.5	37.3
2014/15	10.6	5.7	3.9	0.0	0.0	0.2	0.0	0.0	0.2	20.3	14.5	2.9	37.8
2015/16	10.7	5.9	3.7	0.0	0.0	0.2	0.0	0.0	0.2	20.5	9.7	1.7	32.0

Sources: MFED and Statistics Botswana

¹Fiscal year runs from 1st April to 31st March.

²Includes taxes, royalties and dividends

3. Even though fiscal sustainability is not a near-term concern, the inherent volatility of revenues on which the authorities have little control poses a risk for the medium to long term. Clearly, the authorities could potentially raise tax rates in case of an economic mishap, but raising rates is not likely to be a good response in case of a persistent or permanent shock. Instead, the best course of action would be to reduce the dependence on uncontrollable sources of revenue through tax reforms aimed at enhancing domestic resource mobilization and reducing inefficiencies and distortions. These comprise key tax administration improvements and tax policy changes that may increase CIT, PIT, VAT, and property tax revenues.

4. This chapter summarizes key reforms to efficiently mobilize revenue in Botswana. The country has been engaged in extensive technical cooperation with the IMF's Fiscal Affairs Department (FAD) and the Regional Technical Assistance Center for Southern Africa (AFRITAC South) in recent years, with the reports from these activities documenting constraints and containing several recommendations. In the area of tax administration, the Botswana Unified Revenue Service (BURS) has already adopted or is considering to adopt several of those recommendations. In the area of tax policy, the authorities have yet to implement most recommendations.¹ This Annex revisits

¹ M. Grote, S. Caner, and S. Cnossen (2013), "Botswana: Tax Base Broadening by Reining-in Tax Expenditures and Mobilizing Underutilized Tax Handles", IMF/FAD, March; and M. Grote and W. McCluskey (2014), "Botswana: Steps towards Improving Collections from Property Rates", IMF/FAD, November.

the main reforms in the context of the Article IV consultation discussions and the authorities' strong interest in reversing the recent decline in domestic revenue as a share of GDP.

5. Publication and sharing of tax data should be a priority. Both the Ministry of Finance and Economic Development (MFED) and the BURS websites do not provide statistics on tax collection and its details, and no detailed information on tax statistics has been made available to Fund staff during the recent round of discussions. Reportedly, not even the tax policy unit of the MFED has tax statistics that may assist its policy making function, an undesirable situation in an upper middle-income country like Botswana.²

B. Key Tax Administration and Policy Reforms

Improve Tax Administration

6. A Tax Administration Bill is almost ready for submission to the National Assembly. The bill modernizes tax procedures and mandates the establishment of a tax tribunal to handle applications for review of tax administration decisions. Even though the bill is not expected to have a significant effect on collection, it is important for improving BURS efficiency and reducing uncertainty about taxation. Successful implementation will entail BURS introducing immediately the necessary changes while minimizing interference with ongoing tax collection.

7. BURS needs to concentrate its resources on enforcing tax collection from taxpayer groups that are potentially important sources of revenue. Tax administration resources, particularly human resources, are scarce in most countries. For this reason, and to reduce compliance costs for small taxpayers, most advanced and emerging market countries adopt measures like an adequate registration threshold for VAT and simplified procedures for the income tax assessment, and focus collection efforts on specialized Large Taxpayers' Units.

8. A couple of tax reforms in 2015 had mixed implications for the use of scarce BURS resources. On the positive side, a VAT registration threshold increase from BWP 500 thousand to BWP 1 million excluded from VAT a very large number of small taxpayers who were responsible for a very small percentage of the VAT revenue. Besides liberating BURS resources, the change eliminated a source of fraud related to unscrupulous small taxpayers who issue false invoices and whose control was difficult.³ On the negative side, a requirement for universal filing by PIT taxpayers was

² The lack of statistical reports on tax returns imposes a severe limitation on the tax policy making (and, likely, on tax administration too). According to information provided to Fund staff, the current activities of the tax policy unit are restricted to work on proposals for tax simplification and analysis of tax waiver requests.

³ Such invoices were equivalent to a check against the Treasury since they create difficult to detect bogus VAT credits and income tax expense deductions.

introduced, increasing the burden on BURS and having no discernible effect on revenue so far.⁴ A design change that would simplify PIT, release BURS resources for better uses, and likely increase PIT revenue is discussed in the next subsection.

9. Looking ahead, the main priority on tax administration should be to improve the capability of the large taxpayers' unit. A high quality large taxpayers' unit (LTU) is essential for enhancing domestic resource mobilization since more than 70 percent of the tax collected in Botswana comes from large taxpayers. In Botswana, there is an urgent need to fill vacancies, train personnel, and use senior auditors in the LTU and to strengthen the audit and risk functions.⁵

10. Based on the above, discussions during the 2017 Article IV consultation focused on three key actions to improve tax administration, namely:

- Proceed with the passage and implementation of the tax administration bill;
- Repeal the legislative requirement for universal filing of PIT returns; and
- Strengthen capacity at the LTU, especially with respect to its audit and risk functions.

Change PIT Design

11. Botswana's PIT is a typical global income tax although there are some deviations.

Global income taxes apply a schedule of progressive rates to the tax base, which consists of the sum of all types of income and capital gains.⁶ In Botswana's PIT, besides some exemptions (e.g. interest not exceeding BWP 7,800 paid by a bank or building society to a resident), dividends from a resident company are subject to a final withholding of 7.5 percent and capital gains are subject to progressive taxation but separate from the pooled income.

12. Intensification of capital movements during recent decades gave rise to a new income tax model, the dual income tax. The model, which appeared first in Scandinavian countries in the late 1980s, consists of taxing all labor income progressively and all capital income, including capital gains, at a single proportional rate. While the global income tax model emphasizes vertical equity,

⁴ A 2016 FAD revenue administration mission considered that repealing the legislative requirement for the universal filing of income tax returns is a critical issue (A. Masters, T. Letjama, and J. Leigh-Pemberton (2016), "Botswana: Improving Tax Administration Efficiency and Effectiveness", IMF/FAD, May).

⁵ H. Saka (2013), "Botswana: Review of Business Processes in the Large Taxpayer Unit", IMF/FAD and AFRITAC South, April; M. Roche (2015), "Botswana: Review of the Large Taxpayers Unit", IMF/FAD and AFRITAC South, November; and A. Masters, T. Letjama, and J. Leigh-Pemberton (2016), *op.cit.*

⁶ Some countries treat capital gains separately and many of them use a proportional rate on capital gains.

the dual income tax model emphasizes efficiency and is more effective in controlling income from high income taxpayers.⁷

13. Adoption of a dual income tax would serve Botswana well. It would simplify administration and compliance and, likely, stimulate investment. However, full adoption of the dual tax model poses the problem of how to separate labor from capital income in the case of taxpayers that earn business income. The Scandinavian countries' solution is to presume the value of capital income by using relatively complex procedures based on statistics on rates of return and values for business assets. These procedures would be more difficult (but not impossible) to apply in Botswana due to statistical limitations and deficient accounting of taxpayers.⁸

14. A compromise solution would be to tax all passive capital income at a single rate. Under this scheme, all personal passive income—dividends, interest, royalties, rental income, and capital gains—would be taxed at a single proportional rate, while labor and business income would be subject to a progressive rate schedule. This would require some tax design changes and simple modifications in BURS procedures but would enhance economic efficiency by eliminating distortions currently imposed on the choice of assets by the multiple tax rates.⁹

15. Based on the above, the following actions could be implemented to simplify and improve compliance and release administrative resources:

- Tax dividends, interest, royalties, rental income, and capital gains with a final withholding tax with a single proportional rate between 10 and 15 percent;
- Tax labor and business income with the progressive rate schedule;
- Repeal all or most exemptions, and rate and base reductions currently granted to passive capital income;

⁷ Taxation of capital income may distort the choice between current consumption and investment. From an efficiency viewpoint, a consumption tax is preferable. In the absence of capital mobility, high marginal rates on capital income would exacerbate the distortion. However, with the intensification of capital movements, the high rates promote instead capital outflows to countries with relatively low rates. The dual income tax model intends to strike a balance between the equity and the efficiency objectives by taxing capital income at a flat rate lower than the top marginal rate on labor income. Given current intense capital mobility and the fact that tax administrations of developing countries face difficulties to control capital income of high income taxpayers, it is not clear if, in practice, a global income tax is more equitable than a dual income tax.

⁸ Once the presumed value of capital income is obtained, the residual business income is considered labor income.

⁹ Dividends are subject to a final 7.5 percent withholding tax, interest is taxed at 10 percent withholding rate as an anticipation of the annual progressive taxation, royalties are pooled with other types of income and taxed annually but are not subject to a withholding tax, rental income is subject to a 5 percent withholding tax later creditable against the individual's final tax liability (except in the case of non-business rent payments by individuals), capital gains are subject to an annual progressive tax but not pooled with other types of income..

- Release taxpayers with a single source of employment income who have no other type of income except passive capital income from filing annual returns; and
- In the medium-term, introduce a full-fledged dual income tax.

Review Corporate Income Tax Concessions

16. Tax concessions may be hindering CIT collection. There are several concessions that are well-defined in Botswana, like tax reductions to farmers, special treatment for the Botswana Development Corporation group of enterprises and the Botswana Meat Commission, as well as for many classes of gross income listed in the Second Schedule of the Income Tax Act (ITA). There are also concessions granted by means of development approval orders (section 52 of the ITA) or tax agreements (section 54) that are undefined. Their characteristics depend on decisions made by the MFED with the consent of the National Assembly on a case by case basis. This implies that the amount of revenue forgone depends on the intensity with which MFED uses the faculty provided by the Income Tax Act.¹⁰

17. Development approval orders may benefit a specific project or an activity. In these cases, all enterprises carrying out that activity are entitled to tax relief. ITA establishes criteria that must be observed in the analysis of requests but sets no rules for the type of incentive, its intensity, or its duration. Therefore, the concession may take any form, from a simple allowance for training or R&D expenses or accelerated depreciation allowance to rate reductions, tax holidays, and even permanent exemptions.

18. Development approval orders and tax agreements provide flexibility to the authorities but have important shortcomings. First and foremost, they create insecurity for prospective investors since they cannot know if a future competitor will get a better tax deal that may draw them out of the market. Second, most tax agreements, especially those of the mineral sector, contain a stability clause that prevent renegotiation of incentives in the future. Third, it is questionable that the National Assembly has the technical capacity for appraising the request and it is doubtful that the MFED has enough resources to monitor beneficiaries and check whether project promises are fulfilled. Fourth, the orders and agreements, though theoretically public, are rarely publicized and lack transparency.

19. International experience shows that tax incentives must be cost-effective and sparingly granted. Research on investment incentives suggests that tax concessions rank low in the list of factors affecting investment decisions. Political and social stability, existence and quality of the infrastructure, reliability of utilities supplies, business climate and ability to hire qualified workers and management are the factors ranking highest in investors' decisions. Since the revenue forgone by tax incentives also deprives the government from resources to provide a modern and efficient infrastructure and invest in human capital, any tax incentives should be granted sparingly and in cost-effective ways. In this regard, international best practice has shown that accelerated

¹⁰ No quantitative information or studies on the amount of CIT revenue forgone seem to be available.

depreciation allowances or investment tax credits associated to a loss carry-forward period are far more cost-effective and better to attract long-term investments than temporary tax holidays and rate reductions, which tend to attract foot-loose enterprises.¹¹

20. The discussion in the preceding paragraph also applies to special economic zones that some countries set up. Ideally, enterprises that locate in an economic zone should have the privilege of high quality infrastructure, expedite customs procedures and, insofar as they export the produced goods, exemption of customs duties and, to avoid refunds procedures, of VAT on their inputs. No CIT concessions should be granted. However, in case these are deemed essential to attract investors, they should be granted in the form of accelerated depreciation allowances or investment tax credits.

21. Considering the above, the authorities should:

- Ensure that income tax concessions are granted sparingly and only in the form of accelerated depreciation allowances or investment tax credits; and
- If special economic zones are created, avoid CIT concessions but, if deemed necessary, grant them only as accelerated depreciation allowances or investment tax credits.

Streamline Value-Added Tax Exemptions

22. The original VAT designed in Botswana was in line with international standards. The VAT Act, enacted in 2001, designed a general consumption tax with a single positive rate and a rate zero applied only to exports of goods and services and supplies deemed similar to exports. In other words, it was the type of VAT praised in the literature for its neutrality and revenue productivity. The few exceptions were zero-rated supplies of sorghum or maize meal (the staple food of Botswana), and a short list of exempt supplies that included some financial services, some prescription drugs and health services, education services, and accommodation in a dwelling.

23. However, several subsequent exemptions have downgraded the integrity of the VAT. Just before VAT entered in effect (July 1, 2002), an amendment to the VAT Act added petrol, diesel oil and illuminating paraffin to the list of zero-rated supplies. Subsequent Acts included in the zero-rated supplies list several food items, some agricultural inputs, and the supply of the first 5,000 liters of water per month to residential dwellings; and, to the list of exempt supplies, several agricultural implements and domestic passenger transportation by road and rail other than transportation of tourists.¹²

¹¹ See, for example, H. Zee, J. Stotsky, and E. Ley (2002), "Tax Incentives for Business Investment: A Primer for Policy Makers in Developing Countries", *World Development* Vol. 30, No. 9, pp. 1497–1516.

¹² The lists of zero-rated supplies and exempt supplies are the First and Second Schedules to the VAT Act, respectively.

24. Botswana’s VAT C-efficiency fares relatively well in comparison with peers but has fallen sharply over time (Table 5).¹³ Up to 2009, C-efficiency (the ratio between VAT revenue and the revenue that would be obtained if all consumption expenditures were taxed) was over 70 percent. It then fell to around 60 percent in 2010 and further to near 50 percent in 2015. There are two possible reasons for this decline, namely the additional exemptions and zero-rating of items (policy gap) mentioned above, and a possible increase in the compliance gap (i.e. a reduction in BURS efficiency), although the latter cannot be asserted without further analysis.¹⁴

25. VAT exemptions and zero-ratings are ineffective as social policies. Except in the case of fuels, it is apparent that the objective of the VAT tax expenditures is to reduce the burden on low-income families. The implicit assumption is that producers and intermediaries will shift the tax benefit forward to consumers who will be the beneficiaries. Though this assumption is not necessarily true, it is a policy assumption that is often made. However, even if the assumption is true, the policy is not sound because of its lack of focus. Although low-income households spend relatively more on food than the rich, the latter spend much more in absolute value. Consequently, the policy does, in fact, improve the equity of the VAT but the bulk of the revenue forgone by the government accrues to high-income households. Taxing all food and using the revenue to compensate low-income families with well-targeted expenditure policies has instead proven to be a better and more cost-effective policy.

26. The exemptions to education and health services are even more compelling. These consumption expenditures are extremely concentrated in the highest deciles of the income distribution because poor and even low-middle class families cannot afford the cost of private services. They use free education and health services provided by the government. Therefore, if the goal is to truly benefit low-income families, the government could instead use effective progressive taxes and use the revenue to upgrade the public health and education services it provides.

27. Lastly, zero-rating automotive fuels does not benefit low-income households. High-income families are responsible for practically all the final consumption of fuels and, assuming the benefit is shifted forward, they are the sole beneficiaries of the tax expenditure.¹⁵ Apparently, the objective of the policy is to keep low a socially sensitive price. As shown in Table 6, Botswana is the member of SACU with lowest fuel prices and its prices are far below the non-weighted averages of

¹³ C-efficiency is an indicator of the how much of the theoretical tax base—consumption—is effectively assessed by the VAT.

¹⁴ The policy gap is the difference between the revenue that would be obtained by taxing the potential VAT base and the revenue that would be obtained from the VAT base as defined in the legislation. The compliance gap is the difference between the potential yield of the VAT given the base defined in the legislation and the effective revenue. The compliance gap is associated with the efficiency of the tax administration. The IMF performs VAT gap analyses at the request of member countries. The methodology is published in E. Hutton (2017), “The Revenue Administration—Gap Analysis Program: Model and Methodology for Value-Added Tax Gap Estimation”, Technical Notes and Manuals, IMF, March.

¹⁵ It should be noted, however, that domestic passenger transportation services are exempt and that, in the absence of a policy change (taxation at 12 percent or zero), its providers would not be allowed to credit the input tax on fuel.

the 170 countries surveyed. Therefore, the authorities should reconsider if subsidizing rich families by keeping fuel prices low is their goal and if not move swiftly toward better alternatives.

Table 5. VAT C-Efficiency in Middle Income Countries

Country	Year	VAT C-Efficiency ¹	Country	Year	VAT C-Efficiency ¹
Botswana	2005	0.76	Botswana	2011	0.61
Botswana	2006	0.73	Botswana	2012	0.60
Botswana	2007	0.83	Botswana	2013	0.51
Botswana	2008	0.89	Botswana	2014	0.53
Botswana	2009	0.75	Botswana	2015	0.51
Botswana	2010	0.59	Botswana	2016	0.51
Algeria	2011	0.42	Latvia	2014	0.51
Argentina	2015	0.17	Lebanon	2014	0.39
Azerbaijan	2015	0.56	Lithuania	2014	0.50
Bosnia and Herzegovina	2015	1.06	Macedonia, FYR	2007	0.57
Botswana	2014	0.53	Mauritius	2014	0.55
Brazil	2014	0.52	Mexico	2014	0.32
Bulgaria	2014	0.63	Namibia	2013	0.53
Chile	2014	0.63	Panama	2014	0.68
China	2011	0.58	Peru	2014	0.57
Colombia	2014	0.43	Romania	2014	0.45
Costa Rica	2014	0.46	Serbia	2012	0.60
Dominica	2012	0.68	Seychelles	2015	0.97
Dominican Republic	2014	0.33	South Africa	2014	0.65
Ecuador	2014	0.79	St. Vincent and the Grenadines	2012	0.48
Gabon	2015	0.15	Thailand	2014	0.88
Iran	2009	0.24	Tunisia	2014	0.43
Jamaica	2014	0.25	Turkey	2014	0.42
Jordan	2013	0.67	Uruguay	2014	0.51
Kazakhstan	2014	0.45	Non-Weighted Average		0.53

Sources: Mission database for Botswana 2015 and 2016; IMF/FAD database for all other.

¹ VAT C-Efficiency = VAT Revenue/(Total Final Consumption net of VAT Revenue * VAT Rate)

Table 6. SACU Members—Pump Prices of Petrol and Diesel

Country	Price (US\$/liter) ¹	
	Petrol	Diesel
Botswana ²	0.74	0.70
Lesotho	0.79	0.81
Namibia	0.85	0.84
South Africa	1.00	0.98
Swaziland	0.91	0.90
World Average	1.02	0.90

Source: globalpetrolprices.com

¹ Prices on June 19, 2017

² 34th lower price of petrol and 46th lower price of diesel out of a sample of 170 countries

28. In sum, the gains from rationalizing exemptions and removing zero-rated items greatly outweigh the costs. In this regard, the authorities should reconsider their policies given their stated objective to improve income distribution and mobilize revenue to fund priority spending. The key policy changes would comprise:

- Streamline the lists of zero-rated and exempt supplies in the VAT Act; and
- Replacing exemptions and zero-rating cases intended to act as social policies (e.g. food and transportation services) with targeted social transfers.

Expand Property Rates' Coverage

29. There are three land tenure systems in Botswana: state, tribal, and freehold. The urban areas and national parks are state land; most of the remaining territory, about 70 percent of the area of the country, constitutes tribal land; and only about 4 percent of the territory is freehold land.

30. The government allocates state land. It concedes residential lots for 99 years and commercial and industrial areas for 50 years. The concessions are renewable, transferable to heirs, and negotiable. The state may retake land paying a compensation to the occupier; but the occupier receives no compensation if he/she decides to return the land to government or not renew the concession. The state reserves some plots for allocation to investors. It also offers land to investors through competitive bids.¹⁶

31. Any citizen of Botswana has the right to request tribal land. Traditionally, the tribe chief had held the power to allocate tribal land to members of the tribe. The Tribal Land Act of 1968 shifted this prerogative to Land Boards, which have been in operation since 1970. In 1993, the Act was amended to consider tribal land an interest of the citizens rather than the tribe, meaning that any citizen may request to any Land Board the allocation of a parcel of tribal land. The concession is perpetual though the Tribal Board may retake it paying compensation for the building.

32. Freehold land is privately owned and, as such, may be transacted. However, the transactions are subject to regulations. In particular, the property may be sold to foreigners only if no national wants to buy it and after ministerial approval.

33. There are good reasons for expanding the coverage of property rates. Currently, property rates only cover the town councils in the country. All properties in tribal land are exempt, which creates incentives for large commercial activities and upscale residential development to locate in tribal land near Gaborone and other urban areas where properties are taxable. One of the reasons to expand the coverage of the property rates is to eliminate this distortion that creates unfair competition between commercial activities and those located in the councils. Other important

¹⁶ All rights to land should be registered in the Deeds Registry. The Registry is administered by the Ministry of Land Management, Water and Sanitation Services that is now responsible also for valuation of properties.

reason is to create a reliable source of revenue for local governments. Property taxes are worldwide the most reliable source of revenue for local governments due to the immobility of its base.

34. Expansion of the coverage of property rates will take some time. Besides change in legislation, it requires property registration and valuation as well as training for local administrations. According to information from the Ministry of Land Management, Water and Sanitation Services (MLM), all urban properties are registered and the registration process for tribal land is in course, with 80 percent of the properties already registered. It is expected that the registration processes will be completed by end-2017. After the ministerial reform, MLM is also in charge of property valuation. Besides valuating all the newly registered property, it will be necessary to review the values of urban properties since revaluation has been long overdue. This may take some time as it requires careful technical preparation, planning and budgeting.

35. Cooperation between MLM and BURS in preparing property rates bills will increase revenues. Local government tax administrations are poorly equipped and local political leaders are reluctant to impose burdens on potential voters.¹⁷ In Botswana, they depend on information from MLM to prepare the bills. BURS, on its turn, has up-to-date information on the occupiers of properties because they are taxpayers. If MLM and BURS cooperate in the preparation of bills, the bill will be more accurate and the value of the potential revenue that each local government may collect will be known. Comparison with the actual revenue collected would indicate the efficiency of the local government collection activity. The indicator may be used to stimulate collection of the rates by, for example, publicizing comparisons of local government efforts and making the amount of transfers dependent, among other factors, on the collection effort.

36. Given the above, the potential to increase efficiency and collection in property taxation in Botswana could be realized by:

- Accelerating plans to register and reevaluate properties to broaden tax base and geographic coverage; and
- Attributing to MLM and BURS the responsibility for preparation of the property rates bills.

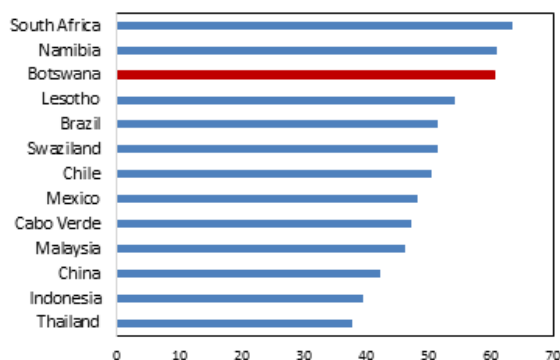
¹⁷ These are usually the reasons why revenue from property taxation is very low in some countries.

ADDRESSING THE UNEMPLOYMENT CHALLENGE

A. Background

1. Despite robust growth, unemployment and income inequality in Botswana have remained high. Since 1991, real GDP growth in Botswana has averaged nearly 5 percent while the unemployment rate has remained persistently high (averaging 18 percent of the labor force).¹ For its part, income inequality is also high by international standards, with a Gini index of nearly 60 (Figure 1). The authorities have recognized the need to successfully address the problems of unemployment and inequality, but results thus far have fallen short of expectations.

Figure 1. Income inequality GINI index



Source: World Development Indicators (WDI), latest estimate available

2. Unemployment and inequality are closely linked. Since wages and salaries are the main source of household income in Botswana, the high rate of unemployment has been a key contributor to income inequality. This is a particularly pervasive problem for young people (including college graduates who have one of the highest rates of unemployment) which has constrained the development of the non-mining economy.²

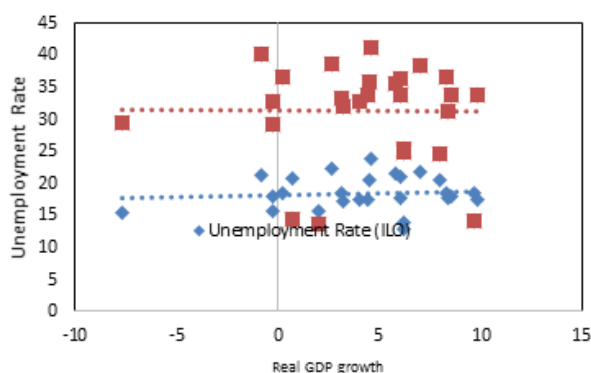
3. Employment in Botswana has shown little responsiveness to changes in economic activity. During the period 1992–2016, the correlations between unemployment rate and real GDP growth and between employment growth and real GDP growth have been quite low (Figures 2 and 3). This is true also for youth unemployment, which averaged 31 percent during the same period. Econometric analysis confirms the limited inclusiveness of growth, with the coefficient that measures the responsiveness of the unemployment rate to GDP growth—the Okun’s coefficient—not being significantly different from zero (Table 1).³

¹ The unemployment rate reflects estimates from the International Labor Organization (ILO) and covers the period 2010–2016. Botswana has not conducted a labor survey since 2006 and the last official labor market statistics come from the 2010 household survey.

² For instance, Berg & Ostry (2011) found that countries with more equal income distributions tend to have longer growth spells and that, to have a sustainable growth path and promote shared prosperity, the effects of policies on inequality should be considered.

³ These regressions follow Furceri (2012). The Okun’s law refers to the empirical regularity, usually verified in macroeconomic data, according to which the unemployment rate is negatively correlated with real GDP growth. The data used in the regressions comes from the ILO estimates.

Figure 2. Unemployment Rate and GDP Growth (1991–2016)



Source: ILO & WEO

Figure 3. Employment Rate and GDP Growth (1992–2016)

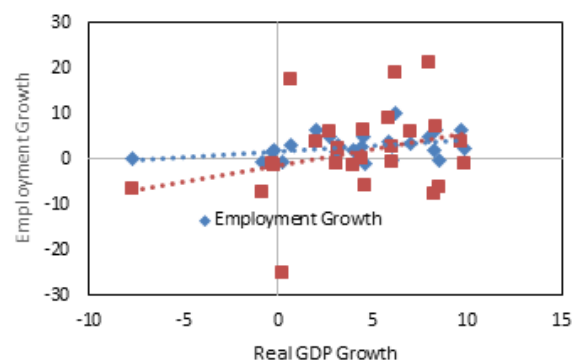


Table 1. Botswana: Okun's Law

VARIABLES	Employment Growth		Change in unemployment	
GDP Growth	0.734 (0.469)	0.849 (0.515)	-0.549 (0.333)	-0.590 (0.367)
Ar(1)		0.176 (0.212)		0.121 (0.212)
Constant	-1.532 (2.705)	-2.334 (3.072)	2.612 (1.921)	2.715 (2.117)
Observations	25	24	25	24
R-squared	0.096	0.121	0.106	0.111
Standard errors in parentheses				
*** p<0.01, ** p<0.05, * p<0.1				

B. Labor Market: Diagnosis of Constraints and Policy Options

4. Botswana's employment challenge is related to constraints in both the supply and the demand for labor. On the supply side, lack of skills in the labor force and skill mismatches have been the most serious challenge, compounded by an overly restrictive policy on permits for foreign workers and high wages in the public sector. On the demand side, a small domestic market, shortages of electricity and water, and barriers to set up and fund businesses have resulted in high costs and lack of profitable investment opportunities, effectively deterring entry of new businesses and employment creation.

Labor Supply

5. Despite investments and improvements in education in recent years, challenges remain. Net primary enrolment rates rose from 80 percent in 2000 to 93 percent in 2014.⁴ However, several children do not progress to the secondary level, where enrolment is just 61 percent (although it rose by about 7 percentage points in the past decade), and most students abandon school by the time they reach the senior secondary level.⁵ These shortfalls in educational participation are greater in rural populations. In 2015, Botswana released an Education & Training Sector Strategic Plan whose objectives are to improve the quality and coverage of education for each level of education and strengthen the match between qualifications and labor market requirements. However, the plan seemed to have been too broad and data constraints prevented the formulation of specific quantitative targets to appropriately monitor progress.^{6 7}

6. Insufficient skills in the labor force and skill mismatches remain a constraint to employment growth in Botswana. According to the World Bank's Doing Business report, the World Economic Forum survey, and the Central Bank's Expectations Survey, these are the key impediments to private sector development in Botswana. In recent years, the authorities have taken some actions to address these challenges, for instance with the creation of the Human Resources Development Council (HRDC) in 2013.⁸ Nevertheless, the HRDC is not yet fully operational as there have been delays in establishing and managing a national labor market information system (Labor Market Observatory) and a national education and skills development data base.

⁴ Net primary enrolment rate is the number of pupils of official primary school age who are enrolled in primary education as a percentage of the total children of the official school age population.

⁵ Systematic Country Report, World Bank, 2015

⁶ Following the 2016 restructuring that divided the Ministry of Education into two (the Ministry of Basic Education and The Ministry of Tertiary Education), the implementation of the Plan has fallen under the Basic Education Ministry. This could be challenging given that the Plan also covers tertiary education.

⁷ The Plan recognizes that the main challenges are improving the availability of data and the quality of education at all levels, although the strategic priorities covers many aspects, implying that more focus on improving quality and data availability would have been warranted.

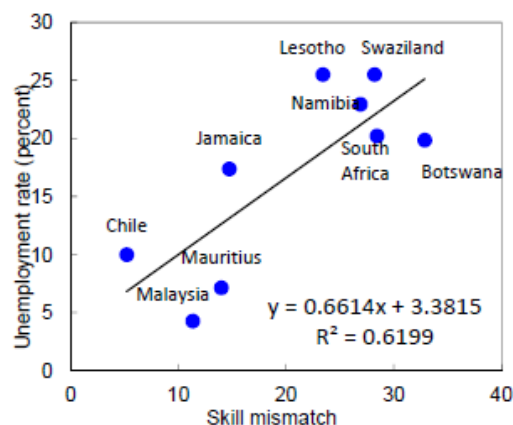
⁸ In a supervisory capacity and acting as Government's advisor on human resource development, the HRDC provides a platform for the Public Sector, Private Sector and Civil Society to act in concert to drive the National Human Resource Development Strategy (NHRDS). Specifically, the HRDC coordinates efforts by all parties to study Botswana's education and skills development mechanism, assess its impact on national priorities, identifies barriers to effective delivery of the NHRDS, and agree on targeted solutions.

7. Skill mismatches have been identified as a key constraint to employment growth. Skill mismatches refer to situations where the level or type of skills in the labor force does not correspond to those sought by firms in the labor market. In fact, Stepanyan and others (2013) found a strong correlation between skill mismatches and unemployment in a study of nine small-middle income countries including Botswana (Figure 4).⁹

8. Another constraint is an overly restrictive policy on permits for foreign workers. The process for requesting an employment permit is unclear, overcomplicated, and occupation-specific. In addition, officials and immigration board members have a significant degree of autonomy, which makes the process uncertain, and there have been complaints about the time it takes to approve permits. According to the biannual expectations survey of the Central Bank, this has been a consistent challenge for the business community. Recent amendments to the immigration bill to facilitate permanent residency for foreign entrepreneur is a move in the right direction.¹⁰ However, this is just a first step and a better-defined process needs to be implemented for all types of workers.

9. Lastly, high wages in the public sector is likely to have a negative effect on the supply of skilled workers to the private sector. Mining (especially diamonds) has been the main source of growth in Botswana since the early 1990s, yet it accounts for just 6 percent of formal employment (Figure 5). This is not surprising, given that mining activities in Botswana are capital-intensive. And while there has been an expansion of activities in construction and services, the public sector has

Figure 4. Skill Mismatches and Unemployment



Source: Stepanyan and other (2013)

Figure 5. Distribution of Value Added and Employment



Source: Botswana's Statistics Office

⁹ Their work followed Estevao and Tsounta (2011), which constructed a skill mismatch index for U.S. states and showed that higher skill mismatches in U.S. states are associated with higher structural unemployment rates.

¹⁰ The Minister of Nationality, Immigration and Gender Affairs may confer the status of permanent residence to a non-citizen who has resided lawfully in Botswana for a period of less than five years where the Minister is satisfied that the non-citizen – a) has established a significant business in Botswana; b) intends to establish a significant business in Botswana; or c) intends to make a significant investment in an existing business in Botswana. Under the amended law, such status may also be extended to a non-citizen's spouse and minor children. The main change is that, before, there was a five-year threshold to be eligible for a permanent residence permit. This means that business owners covered by the reform won't have to renew their work permits on a regular basis.

become the main employer in the economy, accounting for over 50 percent of total employment. More importantly, wage levels in the public sector are higher than in non-mining private sector activities, and are de facto seen as a reservation wage that constrains the supply of skilled labor to the private sector.

10. Over time, the following actions could help address the above-mentioned constraints:

- Implement the Education & Training Sector Strategic Plan without further delay, including by improving data collection and setting and publishing concrete targets (including quantitative targets) to monitor progress.
- Strengthen the capacity of the HRDC to achieve a regular and fluid dialogue between the government and the private sector on all levels of the education system.
- Unify the graduates' registry with the database for internships, expand it to include all levels of education, and open it to the private sector without restrictions. This can be done through the Labor Market Observatory by making it fully operational. In addition, this information should be used to establish and keep an updated register of scarce skills to assist the immigration system.
- Redefine and publish the policy on giving and renewing work and residence permits for foreign workers. Steps include adopting/publishing clear requirements and criteria, granting permits within a short time frame and allowing for longer durations, and reporting the reasons behind rejections. These steps would reduce the appeal rate, increase private investment, and facilitate the transfer of skills to the domestic labor force.

Labor demand

11. A small domestic market and lack of regional economic integration constrain competitiveness in Botswana. Botswana and its neighbors, except for South Africa, have very small open economies. A joint effort towards economic integration of the region has been pursued through SADC, a free trade area protocol established in 1996 and ratified in 2000 among 15 sub-Saharan African countries. However, progress has been slow, mainly because several countries have been reluctant to take down tariffs on goods and services, eliminate provisions promoting local content and subsidies to industries, and remove visa restrictions. An added complication has been that SADC countries belong to various regional groups (COMESA, SACU, EAC), which creates difficulties on the implementation of trade policies.

12. The availability of electricity and water has also been a longstanding concern.

Problems with electricity supply have been—inter alia—associated with the malfunctioning of Morupule B, the major power plant in the country, that experienced repetitive machine failures due to structural defects in project design, leading to frequent outages and forcing the country to import almost half of its electricity needs during 2014–15. Morupule B, the largest power station in

the country, was expected to be completed by October 2012, but by the end of 2013 only two units were in operation. The remaining two units were completed in 2014. The plant has been beset with machine failures, forcing the facility to run at about a third of its capacity. Another challenge facing is associated with water provision, as the existing infrastructure is inadequate in size and suffers from weak maintenance.

13. Botswana has been successful in ensuring access to clean water but water losses and sanitation problems have been a concern, with more than 95 percent of the population having access to improved drinking water sources. However, as the country relies heavily on groundwater (60 percent), it remains vulnerable to droughts. In addition, the water system has operational problems related to under-dimensioning and insufficient maintenance, which leads to water losses. Finally, despite some progress, sanitation remains an issue, with only 64 percent of the population having access to improved sanitation.¹¹

14. In the electricity sector, steps have been taken to improve production and reliability. An international expert has been hired as CEO of the Botswana Power Corporation (BPC) and a plan to improve the financial sustainability of the company has been developed (Masa 2020) with the goal of reaching financial self-sufficiency by 2022. This entails downsizing the company, shifting the production of electricity to the private sector while maintaining the distribution side, and gradually liberalizing tariffs.

15. Similarly, prospects for the water sector have improved, but challenges remain. Water supply improved as dams received inflows from rain following two years of drought. Furthermore, a second North-South water carrier—to irrigate as much as 35,000 hectares—is expected to be completed by 2022 and other large projects are also under consideration, including the Chobe-Zambesi carrier (that would channel water from the Zambezi), the Lesotho Island water transfer (through South Africa) and the Botswana/Namibia/South Africa underground.¹²

16. Lastly, the cost of doing business has been unnecessarily high because of distortions and bureaucratic procedures. The main challenges are: (i) Starting a business: in Botswana, it takes 48 days to start a business compared to just 6 days in Mauritius. To address this issue, the authorities need to introduce a unique identification number for each company and use this number as the only reference for interaction between the company and government agencies. Additionally, the authorities should establish a one stop shop to speed up starting a business. (ii) Obtaining construction permits: in Botswana, it takes 17 days to get a construction permit, compared to 10 days in Namibia. Since the legislation does not permit to classify construction by risk level, all new constructions require inspection. This can be addressed by amending legislation to introduce a risk-based on-site inspection system; (iii) Accessing to credit: there is not credit registry in Botswana,

¹¹ World Bank, 2015 Systematic Country Report. Improved sanitation facilities include flush/pour flush (to piped sewer system, septic tank, pit latrine), ventilated improved pit latrine, pit latrine with slab, and composting toilet, as defined by WHO.

¹² In addition, the Government and IBRD recently signed a US\$ 145.5 million loan agreement for an emergency water security and efficiency project that will help reduce water supply disruptions.

while the credit bureau covers only about ½ of adults, collects only negative information, and is not easily accessible to the lender; and (iv) Trading across borders: the time it takes to process documentation is too long and can be usefully shortened.

17. In 2015, the authorities adopted a roadmap for reforming Botswana’s business environment, but progress now needs to be accelerated. For instance, important reforms such as the one government principle,¹³ reducing the excessive number of licenses and permits (which are already approved), and establishing creditors databases, still need to be implemented. Insufficient progress with these reforms has highlighted the importance of strengthening capacity, ownership, and accountability of the entities responsible for implementation.¹⁴ In addition, regular updates on the implementation of the reforms could be submitted to Cabinet to increase accountability.

18. Proceeding with pending reforms and investments on the above areas will lower costs and foster private investment and employment. In particular, the following actions will be important in the period ahead:

- Ensure a consistently improved performance of the Morupule B Power Station within internationally accepted operational standards.
- Make the Botswana Energy Regulatory Authority fully operational, ensure that prices charged by private producers to BPC are in line with marginal costs to avoid rent extraction, and take the necessary actions to avoid any abuse of market power.
- Review the structure of electricity subsidies with a view to rationalize and set rates based on efficiency grounds and commercial criteria and avoid political interference. To protect the poor, subsidies on tariffs for residential consumers can be usefully replaced by a targeted scheme of direct transfers. Pending the design and implementation of such scheme, tariff increases for lower-income households will need to be contained.
- Lower non-revenue water losses by reducing leakages in the existing infrastructure.
- Adopt the unique identification number and implement the one stop shop.
- Introduce risk-based on-site inspections to speed up the granting of construction permits.
- Collect positive and negative data in the Creditor Database.

¹³ The one government principle defines that state bodies (central and local) should not require applicants/ clients to produce documents that are issued by another Government agency. With the assumption that there is communication among state agencies.

¹⁴ Only about one-third of the reforms envisaged have been implemented.

- Allow lenders to enforce securities out of court through a collateral agreement and establish a collateral registry for immovable and movable assets; and
- Reduce the number of documents required for export and import and establish a single electronic window to lower international trade costs.

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