AFRICAN DEVELOPMENT BANK GROUP
GROUPE DE LA BANQUE AFRICAINE DE DÉVELOPPEMENT

COUNTRY FOCUS REPORT 2024

BOTSWANA

Driving Botswana's Transformation

The Reform of the Global Financial Architecture

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ACKNOWLEDGEMENTS

The 2024 Country Focus Report (CFR) for the Republic of Botswana was prepared in the Chief Economist and Vice-Presidency for Economic Governance and Knowledge Management Complex (ECVP), under the direction and supervision of Prof. Kevin C. Urama (Chief Economist and Vice-President), with support from Amadou Boly (Chief Assistant to the Chief Economist), and Amah Marie-Aude Ezanin Koffi (Executive Assistant).

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The team thanks (i) the Botswana Country Team led by Leila Mokaddem (Director General, Southern Africa Regional Development and Business Delivery Office (RDGS)), and Kennedy Mbekeani (Deputy Director General (RDGS) and Country Manager, Botswana); (ii) the Macroeconomics Policy, Forecasting and Research (ECMR) led by Abdoulaye Coulibaly (Director, Officer-in-Charge); (iii) the Transition States Department (RDTS) led by Yero Baldeh (Director); (iv) the African Natural Resource Center (ECNR) led by Désiré Vencatachellum (Director, Officer-in-Charge); and (v) the Macroeconomics Policy and Debt Sustainability Division and Microeconomic and Institutional Impact Assessment Division led by Anthony Simpasa (Division Manager), for their contributions.

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The cover of the report is based on a general design by Laetitia Yattien-Amiguet and Justin Kabasele of the Bank's External Relations and Communications. Copy-editing was done by the Bank's Language Services Department and layout was done by Nana Kwandoh.

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ACRONYMS AND ABBREVIATIONS

AEO	African Economic Outlook
AfCFTA	African Continental Free Trade Area
AfDB	African Development Bank
ALSF	African Legal Support Facility
BWP	Botswana pula
CFR	Country Focus Report
DFI	Development finance institution
FDI	Foreign direct investment
G20	Group of 20
GCF	Green Climate Fund
GDP	Gross domestic product
GHG	Greenhouse gas
ICT	Information and communications technology
IMF	International Monetary Fund
IRP	Integrated Resource Plan
MDB	Multilateral Development Bank
MW	Megawatt
NSP	National Spatial Plan
ODA	Official development assistance
ODC	Okavango Diamond Company
OECD	Organisation for Economic Co-operation and Development
PFM	Public financial management
PIP	Public Investment Programme
SACU	Southern Africa Customs Union
SADC	Southern African Development Community
SME	Small and medium enterprise
SoE	State-owned enterprise
SDR	Special drawing right
SEZ	Special economic zone
TNDP	Transitional National Development Plan 2023/2024 to 2024/2025
USD	United States dollar

EXECUTIVE SUMMARY

Macroeconomic performance and outlook

The mining industry, dominated by the mining of diamonds, is the main driver of growth in Botswana, making it vulnerable to external shocks that affect the demand for rough diamonds and diamond prices on the global market. Economic growth is expected to accelerate from 2.7% in 2023 to 4.0% in 2024, as diamond sales recover. Despite Botswana's prudent economic management and a low risk of debt distress, the country suffers from mixed social outcomes, with a declining poverty gap but persistently high unemployment and inequality, and growth is not fully inclusive. To achieve a pathway of faster and more resilient growth, Botswana should maintain its macroeconomic stability, which is a prerequisite for incentivising greater private sector economic participation. It should also maintain its current efforts to build resilience; and full implementation of ongoing fiscal sustainability reforms should remain a priority for improved fiscal performance and public sector efficiency. For Botswana to succeed in its diversification efforts away from diamonds, there is a need to reduce the involvement of the Government in economic activity, to allow the private sector to grow.

Taking stock of Botswana's progress towards structural transformation

Structural transformation in the form of economic diversification and higher-skill job creation has been slow in Botswana, with limited industrialisation. Low-skilled workers leaving the agriculture sector have been absorbed by the low-skill services sector rather than the manufacturing sector, which has very high potential to ignite structural change through improved skills development. The contribution of labour productivity to total factor productivity has been limited. New evidence suggests that, despite impressive growth of the services sector, the government and the private sector should invest more in the manufacturing sector, which typically generates higher productivity jobs at scale. Options which Botswana might consider to accelerate its structural transformation include improving economic policy for export diversification; investing in quality public infrastructure for agricultural transformation; fostering integration into regional value chains and markets; and investing in human capital to develop cognitive skills and reduce the skills mismatch.

The need for reform of the international financial architecture

The current uneven set-up of the international financial system, while often favouring advanced and emerging economies, limits the economic transformation potential of many African countries by imposing stringent conditions on their access to international finance, as subjective credit ratings may generate a general high-risk perception of African countries among international investors. However, Botswana may be an exception to this observation, as its recent favourable credit ratings afford it access to international markets at relatively low attractive rates.

There is a need to ensure that the international financial institutions are robust and that the goals of their financing are achieved. The Bretton Woods Institutions were set up in the wake of World War II, to avoid another world war. However, given the evolving structure and challenges of the contemporary world, it is time to reform these institutions, and the allocations of their shares and quotas. Botswana has the potential to become a major player and contributor to mobilisation of financing for funds within a reformed global financial architecture.

INTRODUCTION

The Republic of Botswana is a resource-rich, landlocked country in the Southern Africa region, with an area of 581,730 square kilometres. It has one of the lowest population densities in the world (4.1 people per square kilometre) and a relatively young population, with 31.3% of its 2.36 million people under the age of 15 in 2022. As per capita income has grown rapidly over the last three decades, from USD 2,320 in 1989 to USD 6,900 in 2023, Botswana has transformed itself from an underdeveloped country to an upper middle-income country, underpinned by political stability and prudent economic management, and with a transformational agenda to make the leap to high-income status by 2036. However, despite its efforts to diversify, Botswana continues to experience limited economic diversification and poor social outcomes, and its growth has not been sufficiently inclusive. The country is highly dependent on the diamond mining industry and a large public sector. The capital-intensive nature of the mining sector and its weak linkages with other economic sectors have limited value chain development and job creation. As a result, there has been limited structural transformation in the economy. While poverty levels have fallen drastically, human development outcomes are below the norm for upper middle-income countries.

The Botswana Country Focus Report (CFR) 2024 aims to replicate at the country level the analyses conducted at the continental level by the African Development Bank (AfDB) African Economic Outlook (AEO) report for 2024. The CFR is therefore articulated around the following chapters: Chapter I discusses Botswana's recent macroeconomic performance and outlook. Chapter II takes stock of the country's structural transformation process. Chapter III discusses the need for reforms of the international financial architecture to finance structural transformation in Botswana. Each chapter offers policy recommendations.

MACROECONOMIC PERFORMANCE AND OUTLOOK

1

1.1 Key Messages

- The mining industry, dominated by the mining of diamonds, is the main driver of growth in Botswana, making it vulnerable to external shocks that affect the demand for rough diamonds and diamond prices on the global market. Economic growth is expected to accelerate from 2.7% in 2023 to 4.0% in 2024, as diamond sales recover.

- Despite prudent economic management and a low risk of debt distress, the country suffers from mixed social outcomes, with a declining poverty gap but persistently high unemployment and inequality, and growth is not fully inclusive.

- To achieve a pathway of faster and more resilient growth, Botswana should maintain its macroeconomic stability, which is a prerequisite for incentivising greater private sector economic participation. It should also maintain its current efforts to build resilience; and full implementation of ongoing fiscal sustainability reforms should remain a priority for improved fiscal performance and public sector efficiency. For Botswana to succeed in its diversification efforts away from diamonds, there is a need to reduce the involvement of the Government in economic activity, to allow the private sector to grow. Reducing government intervention includes creating an enabling environment for private sector growth, encouraging entrepreneurship, reducing bureaucratic hurdles and promoting a more market-driven economy.

1.2 Introduction

This chapter presents an analysis of Botswana's economic performance in 2023 and medium-term growth projections for 2024–2025. It assesses trends, inter alia, in key macroeconomic indicators, fiscal and monetary policies, and changes in domestic and international financial flows, investment and public debt. The chapter also discusses the main upside and downside risks to the outlook and provide policy options to foster rapid and resilient growth, and to support macroeconomic stability and economic transformation.

For Botswana to succeed in its diversification efforts away from diamonds, there is need for less involvement of the Government of Botswana in economic activity to allow for the private sector to grow.

1.3 Growth performance

The growth rate of Botswana's real gross domestic product (GDP) slowed from 5.5% in 2022 to 2.7% in 2023, mirroring the estimated slowdown of global growth from 3.5% to 3.2%. Per capita GDP growth followed the same trend (Table 1). Botswana is a resource-rich country, with economic activity dominated by the diamond industry and a huge public sector. The extraction and processing of rough diamonds for export is the single largest contributor to public revenues (25.1%) and the principal source of export receipts (87%) (Ministry of Finance, 2024; Bank of Botswana, 2024a), making earnings susceptible to swings in global diamond prices. Botswana's climate is semi-arid, with a high frequency of droughts and desertification. These two factors – the diamond market and climate change vulnerabilities – were the main drivers of the growth slowdown in 2023. Global consumer demand was weakened by tight monetary policies globally, and rough diamond sales were further depressed by competing spending choices (cheaper synthetic diamonds, travel abroad post-COVID-19 lockdowns, etc). Persistent drought conditions adversely affected water and electricity production. As a result, the output of diamond traders contracted by 29.4%, and that of the water and electricity sector by 16.9% (Statistics Botswana, 2024a). Aggregate demand was muted, reflecting the decline in net exports.

1.4 Other recent macroeconomic and social developments

1.4.1 Monetary policy, inflation and exchange rate

The Bank of Botswana's monetary policy objective is price stability, which it strives to achieve by keeping the inflation rate within the medium-term objective range of 3-6%. At 5.3%, average inflation in 2023 was within the objective range, having slowed from 12.2% in 2022. This slowdown in inflation reflects the effects of downward domestic fuel price adjustments, a deceleration of food price increases and lower imported inflation, together with a successful application of monetary policy operation tools. The Bank of Botswana maintained a cautious accommodative monetary stance in support of a continued recovery of economic growth, citing well-anchored inflation expectations, by reducing its Monetary Policy Rate (MoPR) to 2.4% in February and April 2024, having previously reduced it by 25 basis points in December 2023. The MoPR, adopted in 2022, is used to transmit the monetary policy stance through short-term interest rates to credit growth. The subsequent higher lending through new loans, overdrafts and revolving credit facilities both to businesses (up from 10.8% to 12.9%) and to households (up from 3.6% to 5.5%) increased annual private sector credit growth from 6% in February 2023 to 8% in February 2024.

The Central Bank also strives to maintain stability in the domestic financial system by ensuring that banks adhere to prescribed limits on prudential ratios. The banking sector is well capitalised, with its capital adequacy ratio averaging 19.7% in 2023, above the 12.5% prudential lower limit.

The sector's asset quality remained robust, with the ratio of non-performing loans to gross loans relatively stable at 3.7% in December 2023, compared with 3.8% in December 2022. The Bank of Botswana seeks a stable real effective exchange rate for external competitiveness by following a crawling band exchange rate mechanism. In the 12 months to May 2024, the Botswana pula (BWP) depreciated by 4.5% against the South African rand, while appreciating by 1.0% against the special drawing rights (SDRs). Among the SDR currencies, the pula appreciated by 0.5% against the United States dollar (USD). The real effective exchange rate depreciated by 2.4% in the 12 months to March 2024, implying a small improvement in international competitiveness for Botswana as its exports became cheaper and more affordable to its trading partners.

1.4.2 Fiscal policy and public debt

The fiscal deficit widened to 2.5% of GDP in 2023/24, from a balanced budget in 2022/23, driven by lower-than-expected mineral earnings and higher than planned recurrent spending on wages and subventions to state-owned enterprises. The deficit thus remained within the government's internal 4% fiscal rule. The deficit was financed through external and domestic borrowing, together with a drawdown of reserves. External borrowing took the form of budget support loans, while domestic borrowing was through the net issuance of government securities. To rebuild its cash balances and other financial buffers against future shocks, the government plans to moderate any recourse to the Government Investment Account. Botswana is at low risk of debt distress. At 22% of GDP, the country's public debt is sustainable and below the national statutory ceiling of 40% of GDP. In 2024, S&P Global Ratings confirmed Botswana's BBB+/A-2 sovereign credit rating based, among other factors, on its prudent management of its diamond wealth through the Pula Sovereign Wealth Fund and the small government debt burden, which sustained macroeconomic stability. Earlier in 2023, Moody's affirmed the country's A3 rating for its low debt levels and strong political and institutional governance, which countered the effects of weaker global economic activity and mineral wealth concentration.

1.4.3 External position and external financial flows

Botswana's current account surplus fell from 2.9% of GDP in 2022 to 0.9% in 2023, reflecting lower mineral export earnings from underperformance of the diamond trade and lower Southern African Customs Union (SACU) revenues. International reserves improved from USD 4.0 billion (7.6 months of imports) at the end of 2022 to USD 4.8 billion (8.7 months of imports) in January 2024. This increase in the reserves is evidence of Botswana's efforts to restore its balance of payments sustainability and build resilience against any future economic shocks.

1.4.4 Social developments

Botswana, an upper middle-income country with a per capita income of USD 6,900 in 2023, presents a mixed social landscape. The country's low poverty headcount ratio fell from 17.0% in 2019 to 14.5% in 2022, while 20.8% of the population was multidimensionally poor in 2021. With a Gini index of 53.3 in 2015, inequality is high. Unemployment has been kept persistently high, at 25.9% overall (25.4% in 2022) and 34.4% among youths in third quarter of 2023, by a mismatch of skills with requirements of the job market, a weak entrepreneurship culture and limited access to affordable finance. Despite Botswana's high adult literacy rate of 88.6% (15 to 65-year-olds), 39.8% of those in formal employment had only secondary school education as of September 2023.

Table 1: Macroeconomics Indicators

	2019	2020	2021	2022	2023(e)	2024(p)	2025(p)
Real GDP growth	3.0	-8.7	11.9	5.5	2.7	4.0	4.3
Real GDP growth per capita	1.1	-10.6	10.2	3.9	1.0	2.4	2.7
CPI inflation	2.8	1.9	6.7	12.2	5.3	4.5	4.0
Overall fiscal balance, including grants (% of GDP)*	-6.2	-9.4	-0.1	0.0	-2.5	-1.8	-0.3
Current account balance (% of GDP)	-6.9	-10.3	-1.4	2.9	0.9	1.1	1.2
Total population (million)	2.5	2.5	2.6	2.6	2.7		
Life expectancy at birth (years)	65.5	65.6	61.1	65.9	66.1		

*Source: data from domestic authorities; estimates (e) and predictions (p) based on authors' calculations. AfDB Statistics Department, April 2024. * Data for 12 months ending 31 March in the following calendar year.*

1.5 Macroeconomic outlook and risks

1.5.1 Outlook

Economic growth is expected to rebound to 4.0% in 2024, as diamond sales recover. The Bank of Botswana (2024b) has assessed the economy as operating below full capacity. Consequently, inflation is estimated to decline to 4.5% in 2024, remaining within the Central Bank's target range. The fiscal deficit is projected to narrow to 1.8% of GDP in 2024/25, supported by improved public financial management (PFM), reforms to the business environment and the successful implementation of the two-year Transitional National Development Plan (TNDP). A current account surplus of 1.1% of GDP is projected, aided by higher diamond earnings and SACU revenues. Unemployment may be addressed in part by the 2023 diamond sales deal with De Beers, under which Botswana's control of diamond production was increased from 25% to 50%, which is expected to generate new jobs along the industry's value chains (Box 1.1).

1.5.2 Risks

The outlook's upside risks include increased domestic rough diamond output and value-added diamond production, and the full implementation of reforms that will enhance the development budget execution, widen the tax base, and lead to higher growth. The downside risks include higher than expected inflation from supply chain disruptions as geopolitical tensions rise, weaker diamond trade if demand remains depressed, weather patterns arising from El Niño and persistence of weak economic conditions in South Africa, dampening demand for Botswana's exports.

1.6 Policy options to foster faster and resilient growth: supporting macroeconomic stability and economic transformation

Analysis of the context of Botswana shows a country that is highly dependent on its diamond industry, with employment in mining and quarrying and in wholesale and retail (a proxy for diamond traders)

Box 1.1: The 2023 diamond sales deal between Botswana and the De Beers Group

In June 2023, the Government of Botswana and the De Beers Group agreed in principle on a new 10-year Sales Agreement covering Debswana's rough diamond production until 2033 and a 25-year extension of Debswana's mining licences until 2054. Debswana, a partnership between the government and De Beers, operates four diamond mines: Jwaneng, Orapa, Letlhakane and Damtshaa. The agreement focuses on four key areas:

- **Industry leadership:** the agreement significantly expands Botswana's footprint and strengthens its leadership across the diamond value chain, including increasing the share of the Debswana supply sold via the state-owned Okavango Diamond Company (ODC) to 50% over the life of the agreement. At the start of the contract, ODC will receive 30% of Debswana production (up from the current 25%), increasing progressively to 50% by the end of contract, ensuring a sustainable transition path for both partners.

- **Debswana's future:** the agreement progresses the long-term capital investment required to secure Debswana's position as one of the world's leading diamond producers, and Botswana's largest private employer, for decades to come.

- **Economic diversification:** the agreement accelerates Botswana's economic diversification through the creation of a multi-billion-pula Diamonds for Development Fund, with an upfront investment by De Beers of BWP 1 billion (USD 75 million) and further contributions over the next 10 years potentially totalling BWP 10 billion (USD 750 million), with the aim of financing productive activities in other economic sectors to create substantial additional value to the Botswana economy.

- **Botswana jobs:** the agreement creates the potential for tens of thousands of new jobs in Botswana, both within an expanded Botswana-based diamond industry and in emerging sectors, with a focus on supporting the growth of a knowledge-based economy.

Source: adapted from the De Beers Group webpage https://www.debeersgroup.com/media/company-news/2023/pr-07-01-23

totalling 23% (Statistics Botswana, 2024b). While economic growth is robust and economic management is prudent, with low medium-term risk of debt distress, growth has not been sufficiently inclusive, job creation has been limited and social outcomes have been mixed. A mix of policies is needed in the short, medium, and long term to address Botswana's macroeconomic challenges and put the economy back on the path of sustained faster growth to achieve its vision of becoming a high-income country by 2036.

- In the short term, the country should sustain macroeconomic stability, which is one of the pre-requisites for greater private sector economic participation. Botswana enjoys peace, political stability, good governance, strong public institutions and prudent management of its diamond wealth. Together with a transparent and well-communicated monetary policy, this context engenders enduring macroeconomic stability. In 2022, the Bank of Botswana introduced several reforms to its monetary policy framework to improve the effectiveness of the transmission of monetary policy actions to prices. The subsequent easing of business planning should encourage greater private investment in larger scale projects and the creation of permanent work that will reduce high unemployment and inequality.

- To develop its human capital further and address the persistent challenge of youth unemployment in 2024/25, the government is developing an economy-wide integrated digital

Box 1.2: Examples of Botswana's niche markets

Mineral beneficiation

- The government has an objective of increasing the value added to its abundant mineral resources within the country through mineral beneficiation, to generate higher revenue and more jobs in the mining sector. Botswana has great potential for minerals beneficiation in upstream activities, including exploration opportunities in base metals such as copper, platinum, gold, nickel and iron.

- Under its economic diversification and sustainable growth strategy, the government has established the Mineral Development Company Botswana and the Diamond Trading Company Botswana. The former supports local projects with financial and technical assistance, while the latter, a joint venture with De Beers, focuses on marketing Botswana's rough diamonds. The mineral beneficiation strategy is further supported by tax incentives and exemptions on import duties for related equipment in s.

The beef industry

- Ongoing initiatives under the adopted cluster development model for export-led growth include the beef cluster in the Lobatse Special Economic Zone. The Botswana Meat Industry Regulatory Authority Act was passed by Parliament on 19 July 2023 to liberalise the meat industry and promote its competitiveness. The Act is also intended to strengthen the existing regulatory framework and to promote research, innovation and quality assurance programmes.

- Under the second Two-Year Transitional National Development Plan 2023/2024 to 2024/2025(TNDP), the government has set out strategies to liberalise the Botswana Beef Export Market, opening up the sector to private firms. It intends to achieve this by (i) establishing a meat regulation office to set and enforce standards and regulations, and to encourage competition and competitiveness in the liberalised sector, while avoiding the creation of distortions such as price controls; (ii) attracting a strategic partner and partially privatising the Botswana Meat Commission; and (iii) developing a commodity-based trade, possibly the form of concession abattoirs owned by the government or the private sector to accommodate meat from the red zone in collaboration with the other Kavango-Zambezi countries (Angola, Namibia, Zambia and Zimbabwe).

Source: EU-Botswana Business Forum 2023 Mineral Factsheet; TNDP.

Labour Market Information System that will guide the development of effective policies and programmes on unemployment, productivity and skills mismatch. This initiative, among others (Annex 1), will ensure that the education sector produces the requisite skills for the job market.

- In the short to medium term, the country should maintain its current efforts to build resilience. Botswana recognises its reliance on a small export base, which makes it vulnerable to external shocks. To rebuild its cash balances and other financial buffers against future shocks, the government plans to moderate any recourse to its international reserves, and instead emphasise the harnessing of domestic resources. To maximise the benefits, the government should simultaneously grow its tax base, given its small market size. Despite its small population (2.36 million people in 2022), Botswana has a relatively strong human capital base. The presence of a highly literate adult population (88.6% in 2014 among 15 to 65-year-olds) serves as a strong springboard for innovation. If harnessed in conjunction with investment in the services sector, this offers a viable channel for structural transformation. Export earning capacity could be further enhanced by accelerating engagement in higher value-added production in niche areas such as mineral beneficiation and the beef industry (Box 1.2).

- In the short to medium term, full implementation of the ongoing fiscal sustainability reforms should remain a priority to improve fiscal performance and public sector efficiency. To address spending efficiency, the government has adopted the Development Manager Model to ensure timely implementation of projects and intends to strengthen project screening and selection through the adoption of a three-stage project appraisal process (pre-feasibility, feasibility and independent review). Scaling up domestic resource mobilisation should be a top policy priority for Botswana to accelerate structural transformation. In this regard, the ongoing review (consolidation, simplification and modernisation) of tax laws will serve to improve tax governance. Planned tax administration reforms to maximise revenue collection, such as digital marking and tracking of excisable goods and the implementation of the National Single Window for an efficient international supply chain, should be fast-tracked. A new three-year Medium-Term Debt Management Strategy is to be developed and implemented in 2024/25 to improve debt management, further aligning any future borrowing by the government with its risk appetite.

- In the long term, the success of Botswana's efforts to diversify the economy away from diamonds will require less government intervention in the economy. Botswana needs to reform, and possibly privatise, its loss-making state-owned enterprises, whose subventions are a drain on the budget and hamper private sector growth. There is a need for the government to create an enabling environment for private sector growth, encouraging entrepreneurship, reducing bureaucratic hurdles and promoting a more market-driven economy. In this regard, the government plans to support the private sector through domestic value-chain development in niche markets and areas, such as mineral beneficiation, tourism, food processing, education, agribusiness, cattle, small livestock, finance and indigenous products. (See Annex I for more details.)

2

TAKING STOCK OF BOTSWANA'S STRUCTURAL TRANSFORMATION PROGRESS

2.1 Key Messages

- Structural transformation in the form of economic diversification and higher-skill job creation has been slow in Botswana, with limited industrialisation. Low-skilled workers leaving the agriculture sector have been absorbed by the low-skill services sector rather than the manufacturing sector, which has very high potential to ignite structural change through improved skills development. The contribution of labour productivity to total factor productivity has been limited.

- New evidence suggests that, despite impressive growth of the services sector, the government and the private sector should invest more in other sectors, particularly manufacturing, which typically generates higher productivity jobs at scale.

- Options which Botswana might consider accelerate its structural transformation include improving economic policy for export diversification; investing in quality public infrastructure and agricultural transformation; fostering integration into regional value chains and markets; and investing in human capital to develop cognitive skills and reduce the skills mismatch.

2.2 Introduction

This chapter presents a comprehensive overview of recent progress in Botswana's economic transformation in a changing world, identifying key trends, outlining its characteristics and estimating the financing needs to fast-track structural transformation. It will take both a historical perspective on structural transformation (what has been done so far) and a forward-looking approach (what can or should be done in the future to fast-track progress), comparing Botswana's performance with that of other peer African countries, and drawing lessons for the future. The chapter estimates the impact of a wide array of factors on the extent of Botswana's structural transformation and the financing needs and financing gaps, to highlight the main pull and push factors, and policy options.

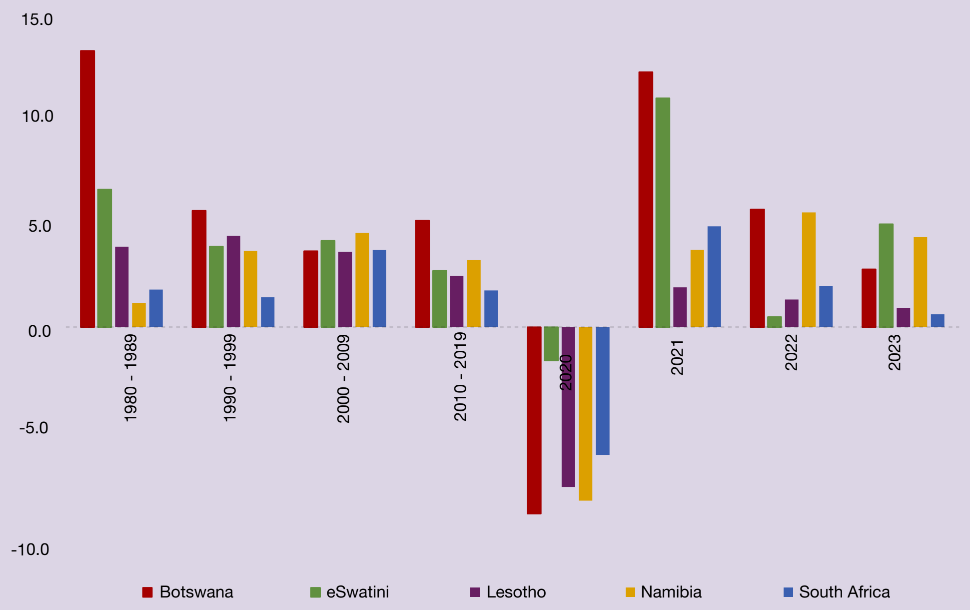
2.3 Taking stock of economic performance and transformation in Botswana

Botswana's GDP and GDP per capita trends tend to have the largest swings among SACU member countries (Figures 2.1 and 2.2), demonstrating the country's reliance on, and thus its vulnerability to, a single commodity, namely diamonds. Over the last four decades, the country has undergone boom-bust economic cycles that mirror the swings in global demand for diamonds. Botswana enjoyed robust economic growth averaging 12.9% between 1980 and 1989, underpinned by political stability and prudent economic management. However, growth declined to an average of 4.5% from 1990 to 2009. During the 2008 global financial crisis, the global diamond market collapsed as a result of reduced bank credit and lower demand. Although growth recovered to an average of 5.0% between 2010 and 2019, supported by the government's countercyclical fiscal and monetary policies, it has remained below the 1980s average.

In 2020, this situation was exacerbated by the COVID-19 pandemic lockdowns, which led to a sharp contraction in GDP, by 8.7%. In 2021, with a recovery in global demand as economies opened up, Botswana's real GDP grew by 11.4%, the largest recovery in Southern Africa, buoyed up by a strong recovery in the mining sector, specifically

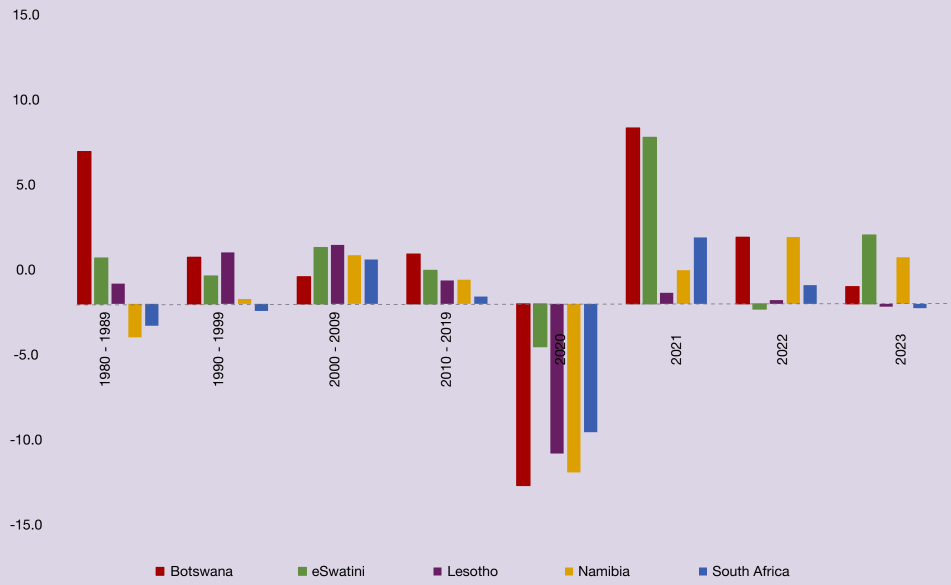
To accelerate its structural transformation, Botswana may consider the options of improving economic policy for export diversification; investing in quality public infrastructure and agricultural transformation; fostering integration into regional value chains and markets; and investing in human capital to develop cognitive skills and reduce the skills mismatch.

Figure 2.1: GDP growth, SACU countries (% p.a.)



Source: data from domestic authorities and AfDB calculations.

Figure 2.2: GDP per capita growth, SACU countries (% p.a.)



Source: data from domestic authorities and AfDB calculations.

diamond trading, and baseline effects. GDP growth has since decelerated, as global demand has been dampened by the interest rate rises associated with tightened monetary policies across the world in the face of higher inflation expectations and the persistent disruption of global supply chains caused by various crises.

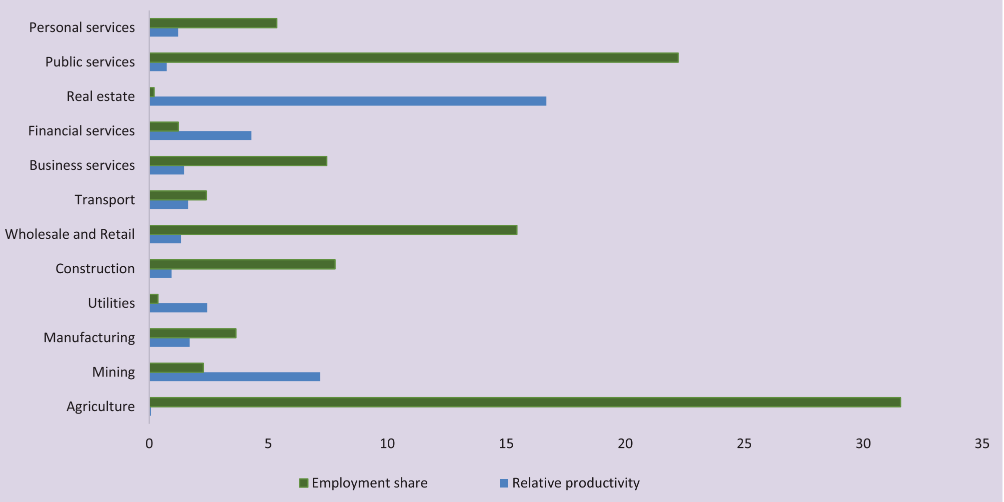
2.4 Botswana's structural transformation: drivers, bottlenecks and opportunities

2.4.1 Botswana's structural economic transformation

Analysis of relative productivity across 12 sectors in Botswana in 2018 shows that the agriculture sector was the least productive, due to the country's semi-arid climate, poor soils and subsistence farming practices. However, the sector employed the largest share of the labour force (31.6%). Relative productivity in the manufacturing sector was also low, dragged down by inefficiencies in water and electricity supply, difficulties in accessing markets and value chains and insufficient foreign direct investment (FDI) flows. The same factors negatively affect output in construction, despite its relatively high employment share of 7.8%, limiting the size of the industrial sector and curtailing economic diversification. While productivity in the mining sector was second only to that of the real estate subsector within services, its capital-intensive nature and weak linkages with other sectors limited job creation, and, by 2018, it employed only about 2.3% of the labour force. The most productive sector, in aggregate, was the services sector, which employed more than 49% of the labour force, mainly in government and public services.

Figure 2.4 presents a more detailed evaluation of changes in the distribution of employment across sectors over the period 1990–2018. This indicates that, while the employment share of the agricultural sector declined gradually, it remained relatively high, falling from 40.2% to about 32%. Similarly, the employment share of the manufacturing sector, which has the potential to drive structural change due to its capacity to absorb low-skilled workers, declined by almost half, from 6.9% to 3.6%. Employment in the construction sector also fell, from 11.6%

Figure 2.3: Relative sectoral productivity and employment shares in Botswana, 2018 (in percent)



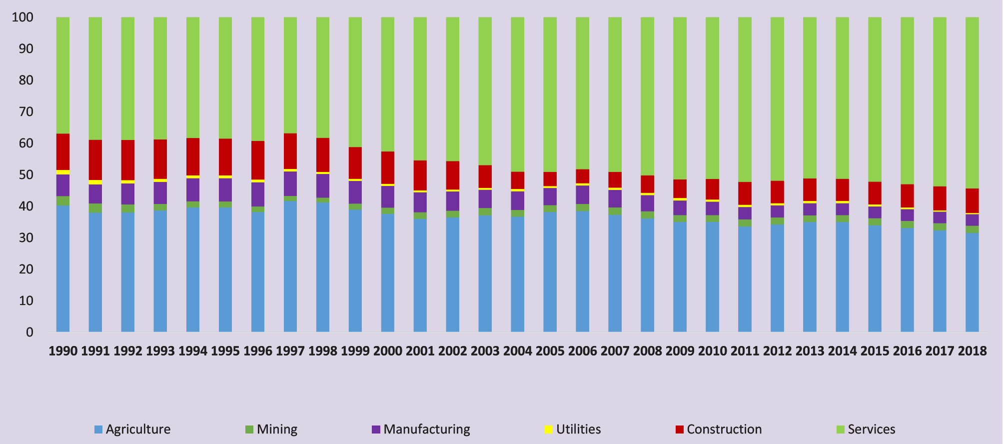
Source: data from domestic authorities and AfDB calculations.

to 7.8%. The employment shares of the mining and utilities sectors, though very small, followed the same trend. This implies that the workers departing from these sectors moved into the more productive services sector, largely being employed in public service, since the government is the largest single employer, and in wholesale and retail. Overall, the employment share of the services sector rose from 36.9% to 54.3% over this period. Botswana's stage of structural transformation may therefore be classified as "structurally developing". While this analysis concentrates on the years up to 2018, reflecting data constraints, the situation is unlikely to have changed significantly by 2023.

2.4.2 Unpacking Botswana's structural transformation through labour productivity decomposition

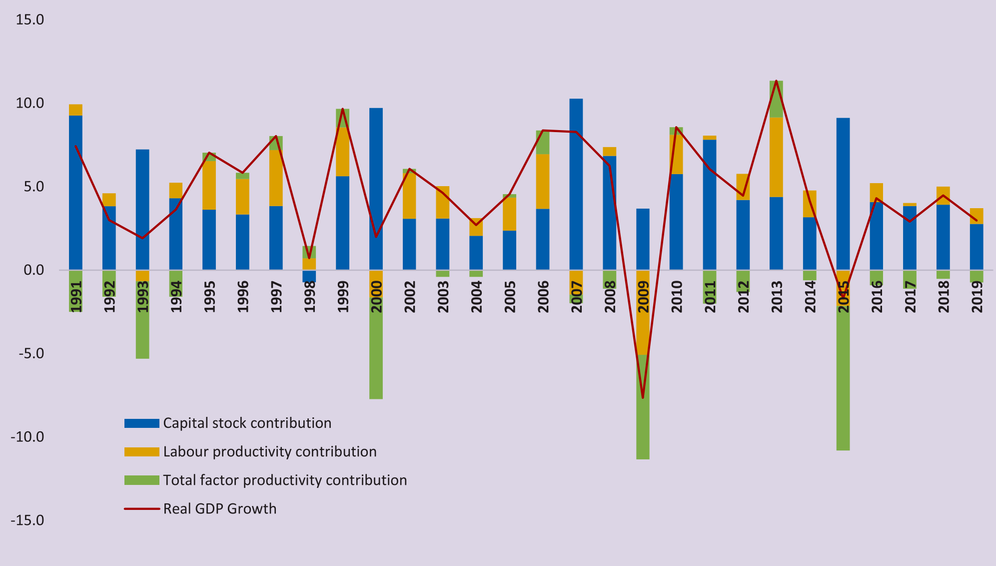
As the analysis in Section 2.4.1 demonstrates, structural transformation can take the form of structural change in which total productivity increases through the reallocation of labour from low- to high-productivity sectors. Structural

Figure 2.4: Sectoral employment shares in Botswana, 1990–2018 (%)



Source: data from domestic authorities and AfDB calculations.

Figure 2.5: Growth of labour productivity, capital stock and total factor productivity, 1991-2019 (% p.a.)



Source: Federal Reserve economic data and staff calculations.

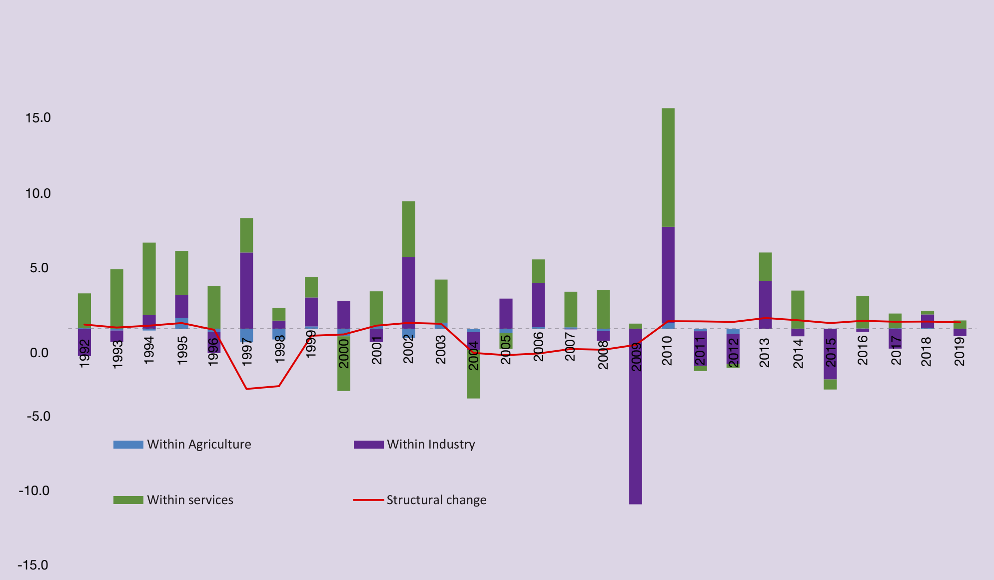
transformation can also result from a within-sector effect, productivity increasing within sectors due to capital investment, technological innovation, efficiency gains arising from intra-industry trade and the reduction of misallocation within sectors. In Botswana, the decline in real GDP growth in recent years (Figure 2.5) is attributable to a decline in total factor productivity, which encompasses the use of new and more efficient technologies and improvements in the combination of inputs, including improvements in governance, regulatory quality and the business climate. The country's transition to upper middle-income status in 2005 saw a decline in total factor productivity, while the contribution of labour productivity to output, though positive, remained small. Growth was mainly driven by accumulation of capital stock, given the capital-intensive nature of the diamond industry.

The contribution of labour productivity to structural change was very small, and hardly changed over 2010-2019. In the earlier years, it fluctuated between negative and near-zero. Volatility of labour productivity was also evident within sectors, especially industry and services, but negligible in agriculture. After 2010, labour productivity declined significantly across sectors (Figure 2.6), as a result of persistent skills mismatch, limited use of advanced technology in production and insufficient investment in capacity-building.

2.4.3 Rapid growth in income and jobs embodied in services exports: new evidence

New evidence from Mensah and de Vries (2024) indicates that the rise of manufacturing output in the early 2000s and its fall in the 2010s were driven mainly by natural resource manufacturing activities. Manufacturing activities outside natural resources thus stagnated, producing only to satisfy local demand. Accordingly, the share of jobs generated by exports decreased across all sectors except services. While the share of jobs embodied in services exports is increasing rapidly, the total share of jobs embodied in these exports (3.0%) is still lower than in manufacturing (3.5%) or agriculture (3.2%). Despite the impressive growth of the services sector (Figure 2.7), the evidence implies that the government and the private sector should invest more in the non-service sectors to increase productivity growth and promote faster

Figure 2.6: Aggregate labor productivity growth: contribution from within sectors and structural change



Source: data from domestic authorities and AfDB calculations.

Figure 2.7: Sectoral domestic value added embodied in exports, 1990, 2007 and 2019 (% of GDP)

Source: AEO 2024.

and more meaningful generation of jobs. Box 2.1 presents the case of Asia.

2.4.4 Drivers to accelerate structural transformation

- Improve economic policy for export diversification: Botswana needs to fast-track economic diversification away from diamonds and broaden the structure of both production and growth. Achieving this would require a new growth model, driven by a diversified and competitive private sector, leading to investment in and development of competitive, outward-oriented firms. Given the country's small domestic economy, successful development of a dynamic private sector in Botswana would be critically dependent on accessing export markets.

- Invest in quality public infrastructure for agricultural transformation: despite its low productivity, the agricultural sector remains central to the livelihoods of the majority of Batswana. Through its output-based Temo Letlotlo (crops) and Thuo Letlotlo (animals) programmes (see Annex I, under Agricultural

Box 2.1: Successful experiences in supporting growth and structural transformation: the case of Asia

- **Structural transformation is one of the critical drivers of growth and development.** The share of agriculture in output and employment declined initially as the share of industry increased, followed by a process of deindustrialisation, during which services became dominant. Productivity was also upgraded from low to high within each of the three sectors. Thus, the structural transformation from agriculture to industrialisation and then services is considered a key driver of successful long-term economic development.

- **In the 1960s and 1970s, most Asian economies were dominated by subsistence agriculture.** More than 60% of Asian labour worked on farms with low productivity, while exports comprised simple labour-intensive products The main drivers of agricultural development were adoption of technologies that improved crop yields, product diversification into new wheat and rice varieties with irrigation investment, expansion of the non-farm economy into livestock and higher-value products, policies conducive to agricultural development, including land reforms that introduced tenant-owner agriculture, and public investment in rural infrastructure.

- **Agricultural development supports economy-wide structural transformation.** There were strong complementarities between agricultural development and industrialisation. Increasing agricultural productivity created a virtuous cycle of rural transformation and development beyond food production and allowed the transfer of surpluses to support industrialisation. Inter-sectoral resource flows, especially labour mobility from agriculture to non-agriculture, stimulated an increase in the wage to capital rental ratio.

- **Asia achieved structural transformation at a much faster rate than other developing regions.** After World War II, the shift to manufacturing was an essential component of Asia's development through export-led growth. There was a rapid and continuous decline in agriculture, with a corresponding increase in the combined share of manufacturing and services in output and employment, partly due to a continuous deterioration of the agricultural terms of trade. At the same time, manufacturing drove growth, because of the large scope for innovation and technological progress, scale economies and the creation of better-paying jobs for a broad section of the population. Japan, China and other East and Southeast Asian economies experienced a major economic transformation as workers moved from primary sector employment in rural areas to cities, where manufacturing employment and production increased substantially. The share of manufacturing in output and employment increased until a certain point, then declined as the economy shifted from the industrialisation stage to deindustrialisation, in which the share of services continued to increase. A services-led growth model bypassed industrialisation and growth of the manufacturing sector and leapfrogged prematurely from agriculture-led development directly into services-led growth.

- **The development of the services sector was also essential to structural change.** The key drivers of Asia's service sector revolution have been urbanisation, information technology and the development of e-commerce, and increasing outsourcing of business processes associated with globalisation. However, labour productivity in the sector remained low because of the dominance of traditional activities, such as wholesale and retail trade, hotels and restaurants, real estate, transport, personal services and public administration. The forward and backward linkages in the services sector were weak.

Source: Sawada (2022).

Development), the government intends to promote agricultural commercialisation through support to market-oriented production, improved market efficiency and increased value addition across the livestock and crop production sub-sectors. The ongoing reforms around development of the public-private partnership (PPP) framework have a potential impact on the transformation agenda, as they are likely to boost economic competitiveness (by supporting infrastructurefinancing) without necessarily adding to the public debt. The government could also accelerate reform actions and boost investment in the provision of:

i. improved basic infrastructure and utilities, including electricity (see Box 2.2), feeder roads for produce transportation and access to production centres, irrigation services, increased access to finance and access to technology for rural small-scale producers;

ii. creation of an enabling environment, with laws and policies conducive to greater private sector participation in agricultural marketing and provision of services;

iii. enhanced efficiency of agricultural markets, including through the use of digital technology to improve information flows, while identifying and securing external markets for strategic crops and livestock where Botswana enjoys a comparative and competitive advantage; and

iv. accelerated adoption of climate-smart agriculture practices, while leveraging new technologies for crop production.

- Foster integration into regional value chains: as a landlocked country with a small domestic market, Botswana participates actively in regional integration and global value chains and is a member of the Southern African Development Community (SADC) and of SACU. Under the SACU arrangement, Botswana enjoys free movement of goods, a common external tariff regime and harmonised rules of origin with the other members. However, Botswana's ability to leverage growing regional market opportunities hinges on addressing supply-side constraints to facilitate integration into regional value chains. This will require the removal of non-tariff barriers to cross-border trade and addressing high transportation costs. More efforts are also required to create an attractive business and investment climate and improve international competitiveness. With the right policies and investment climate, the country's membership of regional bodies and trade agreements offers an opportunity to address the constraints imposed by a small domestic market and to diversify export markets. To take advantage of its central location in Southern Africa, Botswana is developing a Meetings, Incentives, Conferences and Exhibitions (MICE) strategy to promote the country as a preferred MICE destination for the continental and international markets. This move will complement the tourism value-chain.

- Invest in human capital to develop cognitive skills and reduce the skills mismatch: the government has developed strategies for further expansion of access to information and communications technology (ICT) infrastructure and services, including broadband and e-government services. However, harnessing ICT fully will require empowerment of Botswana's youth through digital literacy training and the development of relevant skills. To develop this pipeline of future skills, Botswana should begin by encouraging critical

Box 2.2: Investment opportunities in renewable energy in Botswana

Botswana has considerable renewable energy potential, which remains largely unexploited.

- **Solar:** Botswana has a very high solar irradiation rate, with a global annual horizontal irradiation range of 2,050–2,920 kWh/m2, like that of California, which is among the most competitive solar markets globally.

- **Bioenergy:** Botswana's bioenergy potential from biomass residues is estimated to be more than 19 million tonnes annually, equivalent to approximately 32 million GJ per year. Its biodiesel and bioethanol potential are even more substantial, at 24 million tonnes and 17 billion litres of bioethanol, respectively. The International Renewable Energy Agency (2021) also details biomass potential (residues from crops, livestock, agro-industry, forest harvesting, wood processing and municipal solid waste), with 20 known small-scale biogas digesters installed, and around 100 yet to be commissioned. With respect to biofuels, the assessment quotes a 2016 World Bank study as showing the potential to produce biodiesel from Jatropha curcas and bioethanol from sweet sorghum and sugarcane to be around 1.2 million GJ/year.

- **Wind:** additional analysis indicates that there are some suitable zones for the deployment of wind turbines, mainly in the southern part of Kgalagadi district near Tsabong and in the Southern District, with a technical potential of up to 1.5 GW.

- **Hydropower:** there is also some limited hydropower potential, estimated at 1 MW.

Source: International Renewable Energy Agency (2021).

thinking, creativity, cognitive flexibility and emotional intelligence, as opposed to rote learning, to match the changing nature of work and collaboration in the Fourth Industrial Revolution. This includes increasing the quality of science, technology, engineering and mathematics in secondary, technical and vocational and tertiary education, to develop a workforce capable of competing in technology-driven economies. These curricula should cover all levels of education and ensure that skills development is embedded at every stage.

2.4.5 Key bottlenecks to rapid structural transformation

- Project implementation capacity constraints: there are significant gaps in the capacity of government ministries, departments and agencies to implement the development projects set out in the national development plans for long-term development fully and effectively. There is limited capacity for project monitoring and evaluation. Other capacity constraints exist in procurement and various other institutional capabilities across government ministries, and there is limited experience in and exposure to good practices in project development and preparation. This limitation extends to the development of sector strategies, which is critical to inform the development of future national development plans.

- Private sector constraints: the private sector's productivity and ability to create jobs is constrained by several challenges. The sector is characterised by a few large subsidiaries of South African firms and several domestic small and medium enterprises (SMEs) mainly engaged in financial services, tourism, manufacturing, wholesale and retail activities. The informal sector, estimated to contributed 5.3% of GDP overall, but 50% of the retail sector, faces challenges of poor working environments, limited participation in relevant policy decisions, and inadequate access to favourable credit facilities and to operating space and facilities. These characteristics limit the private sector's contribution to meaningful high value-added production.

- Demographic challenges: Botswana has achieved universal primary education and gender parity in enrolment at all levels of school. Access to health services has also improved, resulting in declining rates of communicable diseases, such as HIV. Despite this progress, however, challenges remain, including high levels of income inequality, low quality of education outcomes and inefficiency of the education system, with limited access to tertiary and vocational education. The high unemployment rate is driven by unemployment among the youth, who make up 53.7% of the total population, and is compounded by inadequate training and skills mismatch. Provision of quality jobs, especially for the youth, is therefore critical to tackling inequality, promoting social stability and exploiting the demographic dividend.

- Climate change challenges: Given its semi-arid climate, Botswana is vulnerable to climate externalities such as extreme weather events (droughts and floods), leading to desertification, land degradation and low agricultural productivity. Between 2020 and 2030, Botswana's estimated climate mitigation financing needs stood at USD 9,200 million. Over 2010–2020, Botswana received climate finance worth USD 0.57 billion, resulting in an annual financing gap of USD 834 million. Private climate finance is generally low, due to the less than comprehensive costing of Botswana's financing needs for climate adaptation; limited institutional investor interest, compounded by limited expertise and an inadequate regulatory environment; perceptions of higher transaction costs in developing bankable projects for green funding; and an underdeveloped renewable energy sector to support the issuance of green bonds. Generating better adaptation data will require sufficient technical expertise at the national level to identify and cost relevant adaptation pathways.

2.5 Finance to fast-track Botswana's structural transformation: the financing gap and the country's commitment to structural change

2.5.1 Structural change strategy in the TNDP

Botswana is implementing a two-year TNDP covering 2023/24 and 2024/25. In its second year, the TNDP is focused on nine key areas for accelerated structural transformation: infrastructure development and spatial planning; sustaining livelihoods; agricultural development; supporting the private sector through reforms to the business environment and value chain development; research and development; innovation and digital transformation; green transition; education and human capital development; and tourism development. These areas are detailed in Annex 1.

2.5.2 Financing needs and financing gap

The Public Investment Programme (PIP) under the TNDP covers the investment projects and other development expenditure of the central government, local authorities and state-owned entities which are financed wholly or partly by government. The PIP has a financing gap of USD 0.7 billion.

Botswana's estimated annual financing needs to fast-track structural transformation are USD 6.6 billion based on the 2030 Agenda for Sustainable

Development, and USD 1.2 billion based on the African Union's Agenda 2063, with financing gaps of USD 6.4 billion and USD 1.1 billion respectively. Using the 2030 Agenda and the Sustainable Development Goals (SDGs) as a reference, the amount required to fast-track SDG 4 (education) is USD 0.02 billion, with a financing gap of USD 0.13 billion. The amount required to achieve SDG 7 (clean energy) is USD 0.04 billion with a financing gap of USD 0.12 billion. The amount required to achieve SDG 8 (productivity, decent work and economic growth) is USD 0.03 billion with a financing gap of USD 0.06 billion. SDG 9 (infrastructure/innovation) has the biggest financing need and financing gap, at USD 6.6 billion and USD 6.4 billion, respectively.

2.5.3 Closing the financing gap through domestic resource mobilisation

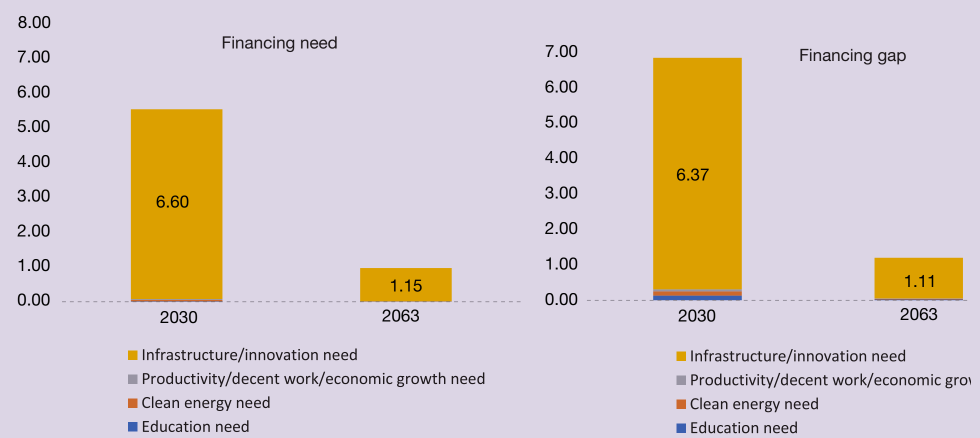
The annual financing gaps for structural transformation in Botswana by 2030 and by 2063 are estimated at 33% of GDP and 5.8% of GDP respectively. This is the third highest financial gap for structural transformation among the SACU member countries, after Namibia and Lesotho (Figure 2.9). The increase in the tax to GDP ratio required to close the financing gap is estimated at 32.7% for 2030, and at 5.7% for 2063. Enhancing the efficiency of public spending and tax collection is thus critical to closing the huge financing gap for structural transformation.

As part of the 2024/25 budget, the government has adopted a fiscal strategy to ensure fiscal stability going forward. Important parts of the strategy are an ongoing review of the tax laws and tax administration reforms towards digitalisation of various processes to enhance domestic resource mobilisation. The latter include the introduction of digital sales, electronic invoicing for efficient value-added tax collection, the use of e-services platforms and a fully operational one-stop boarder post (OSBP) at Kazungula to facilitate trade. Planned reforms include digital marking and tracking of excisable goods, operationalisation of the Mamuno OSBP and completion of cross-border facilities at Pioneer Gate, Lobatse. PIP projects are being implemented using various sources of financing (public and private loans and grants) using PPPs where appropriate.

2.6 Concluding remarks and policy recommendations

Accelerating Botswana's structural transformation will require several actors coming together to support the process.

Figure 2.8: Financing needs and financing gaps in Botswana

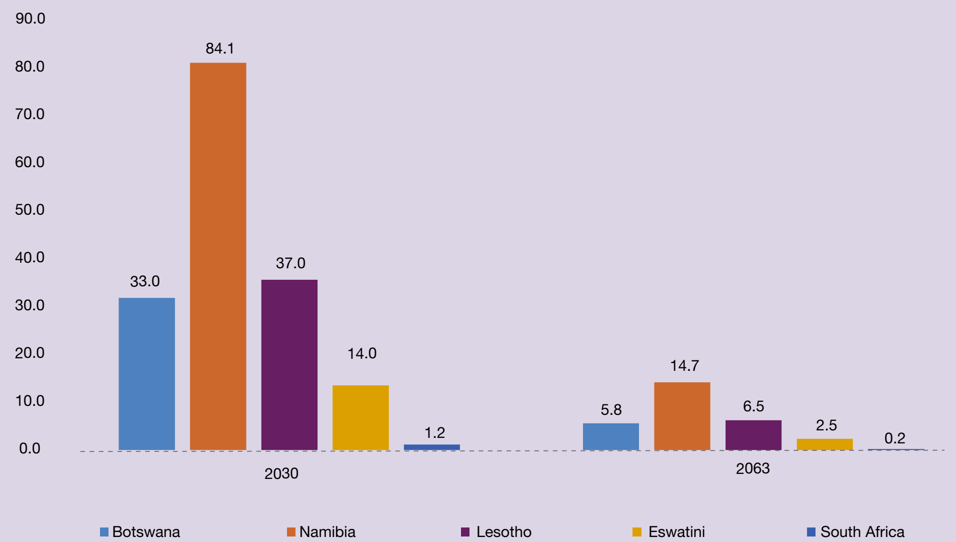


Source: staff calculations based on a database from Sachs et al. (2023), UNESCO, CIA, EIA, NASA, IMF and World Bank.

2.6.1 The role of government

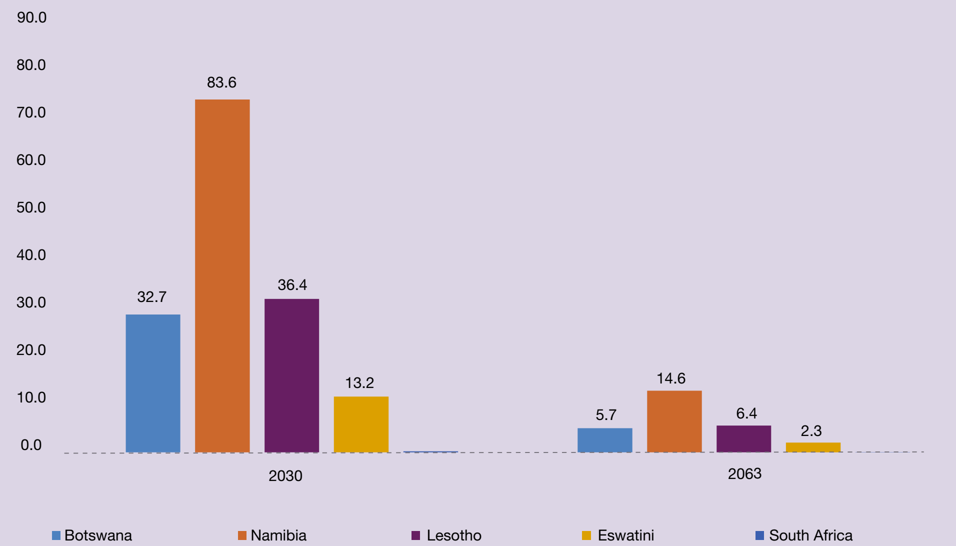
The role of the government is to build strong institutions and implement critical legislative measures to create an enabling environment for the private sector to play a leading role in accelerating structural change. In Botswana, the government has in the past facilitated private sector investment through regulatory reforms and the development of growth-enabling infrastructure using PPPs; improved fiscal performance, PFM and public sector efficiency; and support to the development of SMEs. As shown in Annex 1, the government will continue to reform the business environment in 2024/25 to attract private sector investment, promote entrepreneurship and support value-chain development, by: (i) addressing regulatory efficiency, financial accessibility, market competition, infrastructure development

Figure 2.9: Estimated annual financing gap for structural transformation (% of GDP)



Source: staff calculations based on a database from Sachs et al. (2023), UNESCO, CIA, EIA, NASA, IMF and World Bank.

Figure 2.10: Required increase in tax to GDP ratio required to close the estimated annual financing gap (percentage points)



Source: staff calculations based on a database from Sachs et al. (2023), UNESCO, CIA, EIA, NASA, IMF and World Bank.

Box 2.3: The Bank's support to economic transformation in Botswana: the ERSP budget support operation

The Economic Recovery Support Programme (ERSP) supported government implementation of reforms to create an enabling environment for private sector development. These reforms included industrial development regulations to simplify business registration procedures and a USD 117 million Industry Support Facility designed to provide financing to private sector entities and help to create jobs. The government is reforming its business climate through the Doing Business Reforms roadmap. The Industry Development Act and Trade Regulations 2020 allow over-the-counter issuance of licences and registration certificates; an FDI incentive package includes low corporate tax rates, transfer duty waivers and temporary property tax exemptions; an Investment Facilitation Law, designed to attract private investment, is at the drafting stage; an Investment Board is being established to resolve investor bottlenecks; and a Public Procurement Act is in place.

The government is working on a stand-alone PPP Bill that will cover several aspects of PPP arrangements, including procurement. The Bank is also supporting the implementation of the PPP programme of the Ministry of Finance PPP Unit, through both budget support and a middle-income country grant.

Source: Economic Recovery Support Programme (ERSP)Project Completion Report.

and governance standards; (ii) seizing opportunities in domestic value chains, including mineral beneficiation, tourism, food processing, education, agribusiness, cattle, small livestock, finance and indigenous products; (iii) promoting competitiveness in regional value chains and cross-border trade, to support private sector exploitation of the market access opportunities created by African Continental Free Trade Area (AfCFTA) of 1.3 billon people, following Botswana's ratification of the agreement in February 2023; (iv) building private sector production capacity for international markets under the Botswana Exporter Development Programme (2020–2024); and (v) taking a critical look at current business funding models and support products, with a view to providing tailored innovative financial solutions to the implementation challenges faced in business development.

2.6.2 The role of the private sector

According to the TNDP, the private sector in Botswana is small and relatively undeveloped. It lacks medium- and large-scale enterprises that can achieve economies of scale and compete in global export markets. Many firms are excessively dependent on government, either through public procurement or through consumer spending by public sector employees. Growth and diversification of the private sector to expand its role in economic development is an essential part of the TNDP, and is central both to the transformation strategy and to the economic empowerment of citizens. The TNDP concentrates on three key strategies: reform of the business environment (see Section 2.6.1), value chain development, and special economic zones (SEZs). The value chains prioritised will be those that enhance local raw material development to increase participation in regional, continental and global value-chains. The TNDP points to SEZs as central to the government's efforts to attract FDI, boost domestic investment and promote export-led growth. To attract new investment, the government offers an attractive taxation regime and other incentives, such as exemption from taxation on property transfers. Eight SEZs are under development, in Pandamatenga (cereal production), Francistown (manufacturing and mineral beneficiation), Selebi Phikwe (light manufacturing), Tuli Block (horticulture and sugar), Palapye (fuel and oil production), Gaborone (pharmaceuticals) and Lobatse (beef and textiles).

Not all projects in the PIP are quantified in the TNDP. However, the government is cognizant of the threat any increased borrowing may have to fiscal and debt sustainability in a high interest rate environment. It therefore expects that the private sector will step in to fill the funding gap for bankable projects. The private sector is also expected to drive the much-needed increase in the rate and inclusivity of economic growth through greater investment and job creation once an enabling environment is in place.

2.6.3 The role of regional institutions

As a landlocked country, Botswana is pursuing structural transformation in the context of regional cooperation and integration. It actively supports regional integration and participates in global value chains to deepen its markets. As a member of SACU, Botswana enjoys free movement of goods, a common external tariff regime, proceeds from the SACU Revenue Pool and harmonised rules of origin. Botswana has access to a market of 360.3 million people in the SADC region, where it enjoys reduced import tariffs. Botswana is also part of the Tripartite Free Trade Area agreement between SADC, the East African Community and the Common Market for Eastern and Southern Africa, and has ratified the AfCFTA it signed in February 2019. Given its small domestic market, and with improved competitiveness, Botswana stands to gain from expanded regional market access and demand for products in which it has a comparative advantage, higher intra-Africa trade, lower trade costs, streamlined border procedures and increased FDI driven by mega-projects attracted by the AfCFTA. The Kazungula Bridge commissioned in May 2021 further unlocks the country's trade potential and connectivity along the North-South Corridor. It also positions Botswana as a regional hub for logistics and transit and offers potential for enhanced tourism services through the Kavango-Zambezi Initiative (the world's largest trans-frontier conservation area). The Walvis Bay dry port facility provides Botswana with access to new trade routes to West and Central Africa, presenting opportunities for structural transformation through both product and market diversification.

2.6.4 The role of development finance institutions and the Multilateral Development Banks

Development finance institutions (DFIs) and the Multilateral Development Banks (MDBs) can support the structural transformation process by providing budget support financing to facilitate country reforms that will result in structural change, including creating an enabling environment for the private sector to thrive. Through its programmatic budget support instruments (see Box 2.3), the Bank has supported Botswana in its economic recovery and reform efforts over the years, especially during times of global crises.

DFIs and the MDBs can also support the country through provision of grants or concessional financing as a cheaper alternative to traditional loans, with the potential of additional funds (refinancing or co-financing) being leveraged from the private sector later in the project cycle. Botswana has received grant funding from the Bank to finance its economic diversification efforts, including from the Fund for African Private Sector Assistance; the Middle-Income Country Technical Assistance Fund; the Sustainable Energy Fund for Africa; and the Youth Entrepreneurship and Innovation Multi-Donor Trust Fund. Box 2.4 details some examples of the Bank's support to Botswana under the operational High 5s.

Box 2.4: The Bank's support to Botswana's structural transformation under the High 5s

Feed Africa: the Pandamatenga Agriculture Infrastructure Development Project contributed to the national food security target of increasing total crop production by 20% in 2016.

Integrate Africa: the Bank's support to the technical assistance and capacity-building component of the Multi-National Kazungula Bridge Project contributes to efficient operations of the OSBP, reducing the time taken for processing at the border with Zambia and enhancing the movement of goods and connectivity along the North-South Corridor.

Industrialise Africa: the Non-Bank Financial Institutions Regulatory Authority project equipped the non-banking financial services sector with a risk-based regulatory model in line with international best practice.

Improve the quality of life for the people of Africa: through the Public Enterprises Evaluation and Privatisation Agency project, the Bank built capacity for Botswana's privatisation programme, while the Statistical Capacity-Building project led to the adoption of a release calendar, staff training and improved statistics.

Source: AfDB country briefing notes and project completion reports.

DFIs and the MDBs could mobilise more resources from the private sector and channel them towards the achievement of the SDGs by improving risk-adjusted returns for bankable projects through risk mitigation tools such as guarantees, first-loss equity, grants and insurance products. Since risk-sharing is critical to encourage private sector investment, any instruments that help manage risk are relevant. By leveraging the services of the African Legal Support Facility (ALSF), hosted by the Bank, for capacity-building and legal advice in various areas, the government could strengthen its proficiency in PPP risk assessment, contract negotiations and optimal project pricing solutions, which are crucial for sustainable development. ALSF services are mostly available without charge.

DFIs and the MDBs could also help countries to develop the long-term carbon neutral strategies the formulation and approval of which are preconditions for access to the Global Climate Fund and associated vertical funds. The Bank has mobilised funding from the Africa Climate Change Fund to support Botswana's Long-Term Low Carbon and Climate Resilient Development Strategies.

FINANCING STRUCTURAL TRANSFORMATION IN BOTSWANA: THE NEED FOR REFORM OF THE INTERNATIONAL FINANCIAL ARCHITECTURE

3

3.1 Key Messages

- The current uneven set-up of the international financial system, while often favouring advanced and emerging economies, limits the economic transformation potential of many African countries by imposing stringent conditions on their access to international finance, as subjective credit ratings generate a general high-risk perception of African countries among international investors. However, Botswana maybe, an exception to this observation, as its recent favourable credit ratings afford it access to international markets at relatively low attractive rates.

- There is a need to ensure that the international financial institutions are robust and that the goals of their financing are achieved. The Bretton Woods Institutions were set up in the wake of World War II, to avoid another world war. However, given the evolving structure and challenges of the contemporary world, it is time to reform these institutions, and the allocations of their shares and quotas. In addressing climate financing within the current international financial architecture, Botswana emphasises the need to recognise the disproportionate vulnerability of African nations to the impacts of climate change, and therefore sees the mobilisation of resources on a large scale as essential to climate action.

- Botswana has the potential to become a major player and contributor to mobilisation of financing for funds within a reformed global financial architecture.

3.2 Introduction

This chapter presents the external financing needs for Botswana to achieve structural transformation while dealing with the threat of climate change. It uses the Bank's estimates of financing needs and financing gaps to fast-track structural transformation (AEO 2024) and to finance climate actions (AEO 2022 and 2023) by 2030. The chapter assesses, using the Bank's estimates, Botswana's capacity to increase the tax to GDP ratio to close the financing gaps to fast-track structural transformation by 2030 and by 2063, and motivates the need for reform of the international financial architecture.

Botswana has the potential to become a major player and contributor to mobilization of financing for the funds within the reformed global financial architecture

3.3 Botswana's stand on the need to reform the international financial architecture

The objective of reform of the international financial architecture is to promote a more stable, resilient and balanced global financial system, in part through various reforms to make the MDBs better, bigger and more effective. Issues include implementation of the International Monetary Fund (IMF) quota system, monitoring of progress towards the rechannelling USD 100 billion of SDRs from wealthier countries and follow-up to the creation of a 25th chair on the IMF Executive Board for sub-Saharan Africa.

In its contribution to the 2024 Governors' Digest, the Government of the Republic of Botswana noted that Africa's economic transformation potential was being limited by the lack of fair decision-making in the current set-up of the international financial system, which often favoured developed countries and imposed stringent conditions on African nations accessing international finance. Debt relief entails prescriptive conditions that cannot be met by African countries in the short term, and the current international financial architecture often fails to mobilise resources on a large scale to accelerate Africa's economic transformation. With the right investments in key sectors such as infrastructure, technology and human capital, African countries could significantly boost their economic growth and create opportunities for sustainable development. Botswana believes that reorganisation of the financial architecture would facilitate an improvement in access to cheap funding for critical projects helps African states accomplish SDG objectives more effectively; fair and transparent debt restructuring processes that would benefit Africa; prioritisation of climate finance, benefiting African countries in combating climate change; and create financial markets in Africa, such as green bonds, to meet their unique demands.

3.4 Mobilising additional resources for Botswana's structural transformation

As discussed in chapter 2, successful structural transformation in Botswana requires significant increases in its labour productivity and total factor productivity. Botswana already invests significantly in its human capital. Over the years, consistently high spending on education has resulted in a high adult literacy rate of 88.5%. While this highly literate population could provide a strong springboard for innovation and smart entrepreneurship, this has not been the case. The inadequacy of the supply of skills relative to job market demand remains one of the most binding constraints to growth. The skills mismatch is compounded by a weak entrepreneurship culture and limited access to affordable finance. Since 2022, the government has consistently advocated a change in the mindset of Batswana to improve the country's economic standing. Among the priorities in this campaign are digitalisation, to unlock and support higher productivity; value chain development, to unlock opportunities for new, high-growth companies in the private sector, initially focusing on minerals, tourism, food and education, and to drive the much-needed export diversification; and changing mindsets, to develop entrepreneurship capacity, eliminate the inferiority complex and implement government and strategic reforms that put citizen economic inclusion at the centre of economic development initiatives.

The implementation of these priorities requires additional, scalable investments, not only in human capital, but also in infrastructure, physical capital and technology to increase labour productivity. Additional development financing could come either from domestic sources or from external sources.

The government's preferred sources of financing are domestic borrowing and revenue mobilisation. As part of its fiscal strategy, Botswana is undertaking a combination of reforms in the public expenditure and tax frameworks, sustained revenue mobilisation and debt management (see Chapters 1 and 2) to secure funding for its development programmes, which include education and human capital development, innovation and digital transformation, and research and development. However, these financing sources are unlikely to be sufficient to meet the entire funding needs.

Botswana has the potential to become a major player and contributor to the mobilisation of financing for funds within the reformed global financial architecture. On the external side, the development aid architecture available to Botswana is small, due to its upper middle-income status and its limited dependence on aid. Several development partners scaled down their activities in Botswana as the country transitioned to upper middle-income status, net official development assistance (ODA) being estimated at 0.4% of GDP in 2019, down from 7.1% in 2008. The Organisation for Economic Cooperation and Development (OECD) estimates that Botswana will graduate out of ODA by 2030. Botswana also enjoys strong diplomatic relations, both within the region and in the international community. This is evidenced by many factors including the positions Botswana holds in regional bodies, including second Vice-Chair of the Bureau of the Assembly of the African Union Heads of State, the African Union now being a permanent member of the Group of 20 (G20). The SADC Secretariat is also headquartered in Gaborone. These two factors provide Botswana with a strong platform from which it can use its reputation for strong governance, leadership and cooperation to advocate for reforms to the global financial architecture to establish a level playing field for all.

According to AEO 2024, financing for Africa could be mobilised of through recycling SDRs, as well as the proposed capital adequacy reforms by the MDBs and MDB general capital increases. In August 2021, the IMF allocated SDR 189 million (approximately BWP 3 billion, USD 268.4 million, 1.6% of GDP and 5.6% of gross international reserves) to Botswana based on its quota of SDR 197.2 million (USD 280 million), bringing the cumulative allocation to SDR 246.4 million (USD 351 million). This allocation is held at the Bank of Botswana as the designated fiscal agent of the government. The decision to access SDR allocations remains the prerogative of the government, which is likely to use the additional SDR allocations either to rebuild its reserves or for budget support, should it decide to trade SDR for hard currency through an agreement with another SDR-holding country to provide usable foreign exchange. Should Botswana choose to convert part of its SDR holdings to hard currency, it may pay interest on the difference between the allocation and the remaining holdings.

In relation to climate change financing, Botswana is receiving technical assistance to embed climate change considerations in sectoral and infrastructure development plans through the IMF's Climate Public

Investment Management Assessment. The government plans to mobilise climate financing through green bonds, participating in carbon credit markets. The EU is supporting Botswana's green transformation energy mix initiatives. The country has also strengthened its resource mobilisation for climate investment through the 2021 Green Climate Fund (GCF) programme on energy, clean technology and natural capital. Some seven projects under the GCF, worth USD 81 million, have already been approved. Support to the improvement of national institutional capacities to scale up climate investment will be central to achieving the country's climate finance targets.

3.5 Debt sustainability in Botswana

According to the IMF's latest (2023) Debt Sustainability Analysis, Botswana's risk of debt distress remains low, the country's already low public debt ratio being projected to decline further over the medium term as with the planned fiscal consolidation and as output recovers. Public debt remains low despite large deficits in the last few years, which were mainly financed by a drawdown of cash balances, and therefore little impact on debt. Most of Botswana's external debt is multilateral, with long maturities, and most fiscal revenues are in foreign currency, providing a natural hedge against currency depreciation. Economic diversification reforms will reduce any risks from reduced diamond production over time.

According to AEO 2024, African sovereign Eurobonds were issued with yields above 5% in 2021, compared with an average sovereign bond yield of 1.1% for advanced economies, and of 4.9% for emerging market economies. This spread has been attributed to perceptions of higher risk among international investors, based on subjective credit ratings. However, Botswana is an exception to this general pattern. As noted in Chapter 1, S&P Global Ratings confirmed Botswana's BBB+/A-2 sovereign credit rating in 2024, based, among other factors, on its prudent management of its diamond wealth through the Pula Sovereign Wealth Fund and the low government debt burden, which sustained macroeconomic stability. Such a favourable rating affords the country access to international markets at attractive relatively low interest rates.

While Botswana has a low risk of debt distress, it recognises that the absence of effective mechanisms for debt restructuring often traps African countries in a cycle of debt, limiting their ability to invest in crucial sectors such as infrastructure, health and education. This has hampered economic growth and perpetuated a cycle of poverty and underdevelopment. The government has advocated for integration of sustainability into debt relief plans, to focus resource mobilisation on long-term economic and social development in Africa. While the G20's Common Framework for debt treatment was a step in the right direction, the process has been slowed down by weak negotiating teams on the government side; government hesitation due to perceived challenges by credit rating agencies; the conditionalities involved, including the need to secure a bilateral agreement with China; difficulty in understanding how best to engage the private sector; and lack of information on the arrangement from the G20. Lessons learned include the need for enhanced and realistic timelines to allow the negotiations to be concluded successfully; the need to allow free sharing of information among MDBs; and the positive outcome of the AfDB participating in such global financial safety net discussions with the G20 and sharing its practical experiences on the African continent.

3.6 Financing climate action

Botswana is committed to reducing its greenhouse gas (GHG) emissions by 15% by 2030. The challenge is that, while Botswana represented only 0.02% of global GHG emissions in 2021, its semi-arid climate means that it is disproportionately affected by rainfall and temperature variability. The combination of high dependence on rain-fed agriculture and water scarcity is a threat to food security, nature-driven tourism and livelihoods.

To build its climate resilience, Botswana approved a national drought management strategy in 2019 and a National Adaptation Plan roadmap in 2020. The roadmap prioritises climate change interventions in the agriculture, water and health sectors in line with Botswana's commitments under the Paris Agreement. Efforts to promote climate-smart agricultural practices have led to the development of a Botswana climate-smart agriculture roadmap. The 2021 National Climate Change Response Policy focuses on climate change governance, technological change and investment. In 2020, Botswana developed and issued an Integrated Resource Plan (IRP) for electricity generation over the next 20 years, covering renewable energy technologies such as solar photovoltaic, wind, coal bed methane (CBM) and concentrated solar thermal, as well as batteries for energy storage. The IRP was revised in 2022 to capture related initiatives including the Biogas Pilot Project, the Off-Grid Solar Programme and the Rooftop Solar Photovoltaic Programme, amounting to 135 MW. The IRP aims to derive 30% of its energy mix from renewable sources by 2030, and 50% by 2036.

Botswana has also strengthened its climate investment resource mobilisation through the 2021 GCF programme on energy, clean technology and natural capital. Support to improving national institutional capacities to scale up climate investment will be central to achieving the country's climate finance targets. In its latest nationally determined contribution submission in November 2016, Botswana estimated that it would need around USD 18.4 billion to achieve its 15% GHG emission reduction target by 2030. These funds were required to mitigate emissions in energy and transport sector infrastructure development.

In its 2024/25 budget (see Annex 1, under green transition), the government plans (i) to augment existing donor funds supporting economic resilience and livelihood protection in the climate change space, and focus on projects and programmes that mitigate climate change shocks and ensure sustainable adaptation; (ii) to build on the progress being made in reviewing existing environmental legislation and integrating climate change requirements into PFM strategies; and (iii) to scale up climate financing to increase Botswana's rate of transition from fossil fuels to renewable energy from 2% to 30% by 2030. In this regard, Botswana is part of the Coalition of Finance Ministers for Climate Action. This group supports countries in strengthening their institutional capacities and seeks to enhance international collaboration and collective climate action, including mobilising climate finance.

In addressing the critical issue of climate financing within the current international financial architecture, the Government of the Republic of Botswana emphasises the need to recognise the disproportionate vulnerability of African nations to the impacts of climate change, and the compounding effect of their limited resources for mitigation and adaptation. It therefore sees large-scale resource mobilisation as essential to support climate action in Africa, to ensure the continent's long-term sustainability and resilience.

3.7 Policy recommendations

- Botswana is one of the few countries in Africa whose successful experience in controlling debt should be shared, including by providing practical advice to other African countries on how to achieve and sustain public debt sustainability. The global financial system needs to be reformed to integrate such success stories and lessons into debt products for long-term economic and social development in Africa.

- Botswana's population is unevenly affected by the adverse effects of climate change, including differences by gender and age, with effects on rural and marginalised communities. Climate financing should therefore be mobilised at scale to support such vulnerable population groups and should be de-risked to enhance investment flows to Botswana's private sector. Domestic institutions such as the Botswana International Financial Services Centre, which has a mandate to develop Botswana as a world-class hub for cross-border financial and business services in Africa and the region, could be harnessed to represent the country and negotiate access to climate financing within a reformed global financing framework.

- Botswana could position itself to take full advantage of the redesigned global financial architecture by emphasising enabling reforms that sustainably improve its legal and operational efficiency to attract higher private capital flows, and by strengthening and mainstreaming the technical skills necessary for effective engagement in global financial negotiations and identification of well-targeted bankable projects for investment.

- Botswana could make use of its current strong international relations to advocate for and instigate appropriate changes to global, regional and national institutions involved in the global financial architecture to increase their responsiveness to increasingly complex development challenges in Africa and elsewhere in the developing world, including on debt.

ANNEX I: THE TNDP FOCUS AREAS FOR 2024/25

Infrastructure development and spatial planning	The government plans to make full use of the National Spatial Plan (NSP) to maximise the beneficial impact of development for all Batswana. i. Infrastructure gaps are to be addressed in the water, transport, energy, and ICT sectors and in land servicing. Land servicing projects are to be undertaken in several areas (including SEZs) to accelerate the implementation of the NSP. ii. Implementation of the Village Electrification Programme is to be finalised by May 2024, bringing national electrification to 84% of identified villages. Ready-made boxes are to be provided free of charge to low-income households not connected to the grid. iii. The PPP model is to be leveraged for project implementation. Three projects (involving petroleum storage, coal to liquids and reclamation and treatment of wastewater) are at the stage of procuring private sector developers. iv. Drafting of a stand-alone Bill on PPPs is advanced and is to be presented to Parliament before end-year. The Bill is to provide legal cover and instil confidence in private sector players to venture into PPPs.
Sustaining livelihoods	Social protection initiatives to improve quality of life include: i. continued implementation of the Ipelegeng (unemployment relief) programme, and programmes for remote area development, old age pensioners, orphans and vulnerable children, World War II veterans, people living with disabilities and destitution. ii. prioritisation of access to health care and education through construction, upgrading and maintenance of health facilities, better rollout of health care programmes, and programmes for education, economic empowerment and job opportunities. iii. review of the 2019 Informal Sector Strategy, to facilitate the provision of decent places of operation for informal businesses, provide capacity-building for skills enhancement, improve market access and identify means of formalisation; and iv. the Chema Chema (hustle or hurry up) Fund, a revolving fund seeded by the government with BWP 200 million (USD 14.7 million) in capital, to fundamentally transform the informal sector (which contributed 3.2% to GDP growth in 2023) by acting as a financial lifeline and stimulating employment opportunities.
Agricultural development	With 9.8% of the labour force employed in the agriculture, forestry and fishing industry (Quarterly Multi-Topic Survey, Q3 2023), the initiatives to promote food security and self-sufficiency in FY2024/25 are: i. prioritisation of the necessary supporting infrastructure, including access roads to production centres. ii. provision of financial assistance and inputs to farmers through the Temo Letlotlo (crops) and Thuo Letlotlo (animals) programmes, the latter to be launched in FY2024/25; iii. leasing land parcels for private investment and farmers' use, to address poor land utilisation, including subdivision of eight plots in Molopo Farms, 14 small livestock farms being subdivided into 57 smaller plots.
Supporting the private sector through reforms to the business environment and value chain development	The government continues to reform the business environment to attract investment, promote entrepreneurship and support development of value chains. This will require: i. addressing regulatory efficiency, financial accessibility, market competition, infrastructure development and governance standards. ii. seizing opportunities in domestic value chains, including in mineral beneficiation, tourism, food processing, education, agribusiness, cattle, small livestock, finance and indigenous products. iii. iIncreasing competitiveness in regional value chains and cross-border trade to allow the private sector to seize the market access opportunities offered by AfCFTA, following Botswana's ratification of the agreement in February 2023. iv. building private sector production capacity for international markets under the Botswana Exporter Development Programme (2020-2024); and v. taking a critical look at current business funding models and supporting products with a view to providing tailored innovative financial solutions to the implementation challenges faced in business development.

Research and development	The government is to build capacity for the generation of novel knowledge, and close the gap between basic research findings and their transformation into practical use and economic benefit, by: i. using the Research and Development Programme to drive research across strategic intervention categories including mining, minerals and mineral beneficiation, human health and social sciences, food and agriculture; livestock and veterinary research, and water, environment and climate change; and ii. establishing an all-encompassing intellectual property (IP) motshelo (tontine) scheme and an IP Ideas Incubation Centre to support indigenous research and innovation and empower Batswana to own and protect their IP assets, thereby supporting entrepreneurship.
Innovation and digital transformation	i. The budget for innovation and digital transformation is to be allocated through the Botswana Digital Transformation Strategy, particularly on SmartBots. ii. The Village Connectivity Programme is expected to be completed in this FY. Phases 2 and 3 are at various stages of completion, and Phase 4 preparations targeting 301 villages are progressing well, with a start date of April 2024. iii. With respect to e-government, 170 government online services have been successfully launched to assist businesses and citizens, including licence and permit applications, society services, private security services, marriage services, social services, youth services and police services. An additional 230 online services are planned by end-2025/26.
Green transition	The budget for green transition is intended to: i. augment existing donor funds supporting economic resilience and livelihood protection in the climate change space, focusing on projects and programmes that mitigate climate change shocks and ensure sustainable adaptation. ii. build on the progress being made in reviewing existing environmental legislation and integrating climate change requirements into PFM strategies. iii. scale up climate financing to increase Botswana's rate of transition from fossil fuels to renewable energy from 2% to 30%, by 2030. Botswana is part of the Coalition of Finance Ministers for Climate Change, which supports countries in strengthening their institutional capacities and seeks to enhance international collaboration and collective climate action, including mobilisation of climate finance.
Education and human capital development	i. To ensure that the education sector produces the requisite skills, the government is developing an economy-wide integrated digital Labour Market Information System to guide the development of effective policies and programmes on unemployment, productivity and skills mismatch. ii. The government is also to implement spillover projects (from FY2023/24) that will enhance the alignment between educational qualifications and the evolving demand of the labour market. The General Education Curriculum is to be reviewed to support outcome-based education under the Education and Training Sector Strategic Plan 2015-2020, which itself is in urgent need of review.
Tourism develop-ment	To facilitate implementation of the National Tourism Strategy and Master Plan 2023-2033, the government will: i. continue the upgrading of infrastructure in the Kasane-Kazungula tourism areas; ii. make available new tourism sites to support tourism land ownership by citizens in these areas; and iii. construct two entrance gates at Khawa and Tsetseng to improve infrastructure in protected areas.

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