

The Recent Financial Crisis:
Some Reflections on its Likely
Financial and Economic Effects
on Botswana

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- **Events are still unfolding, and hence difficult to write a complete story about the subject;**
- **As we speak:**
 - **The stock market continues to decline;**
 - **a number of companies are bankrupted and collapsing;**
 - **Many banks all over the world are in some trouble;**
 - **and the job layoffs in each company and in each country is changing by the day;**
 - **Worst yet, many believe, the worst is yet to come, as witnessed by the recent number of job loses.**

- **Hence, this is only a snap-shot of the story to date and only a selected aspect of this complex, ever-changing and far-reaching aspect of the unfolding story.**
- **I don't know how much justice I will do to the complex issue but let me briefly address first the global context and then move on to its relevance to Botswana. And let me start with the following questions, as a background, about the financial and economic crises:**

I. Background:

- (1) How did we get here?**
- (2) What has been the policy response?**
- (3) What are the likely core reasons for this?**

II. Should Botswana Care? How much?

- (4) What are potential and the actual impacts on the Botswana Economy, If any?**
- (5) What policy options are available to mitigate any possible adverse effects:**

N.B. In this presentation , if and when I do not provide detailed sources (since the whole world is talking about it interactively such that the ownership of ideas seems to have melted with capital markets', I will attribute all sources to WIKIPEDIA ENCYCLOPEDIA and other internet sources.

1. How did we get here?

- **The world economy has changed dramatically since September 2008.**
 - **What began as a downturn in the US housing sector is now a global crisis, spreading to both rich and poor economies;**
 - **Many believe this may go down in history as 'the worst crisis since the Great Depression of the 1930s'. Lets briefly look first at the financial sector.**

1.1 In the Financial Sector :

- **It has been simmering for years (particularly in the US housing market). I will come back to the economic fundamentals later, but let me start with some of the frequently cited popular explanations that caused the financial markets to collapse:**
 - **(a) lack of regulation in the financial markets (particularly derivatives related to the mortgage backed securities (MBS);**
 - **(b) excess money supply in the system;**
 - **(c) overheating of the world economy (due to China, India...);**
 - **(d) Commodity price increase;**
 - **(e) irresponsible financial management; and**
 - **(f) greed supported by right-leaning political environment.**

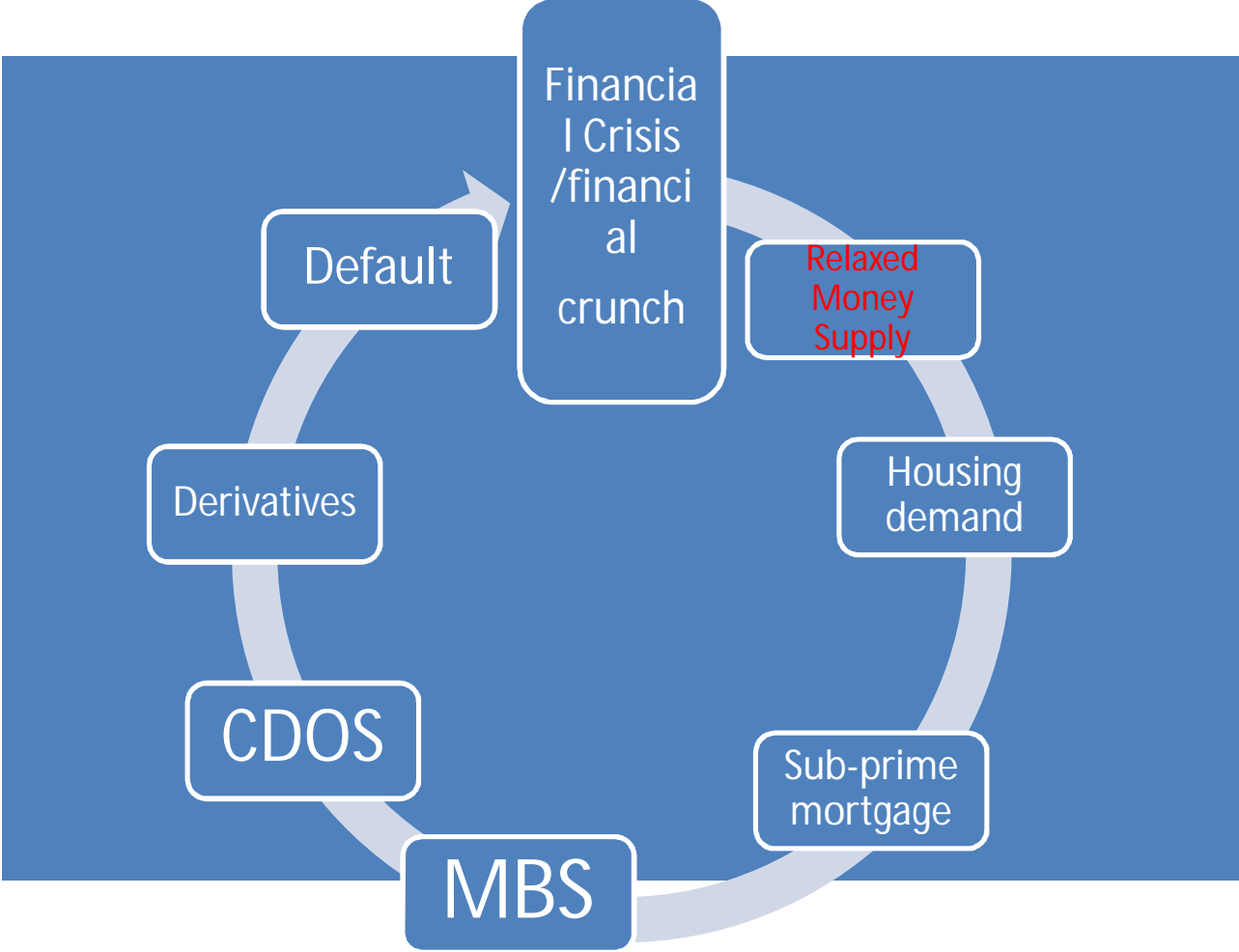
- **These factors led to the chain reactions that resulted in:**
- **The nationalization of the ' Fannie Mae and Freddie Mac on September 8, bankruptcy of the Lehman Brothers, and the bailout of A.I.G (the largest insurance company in the world);**

These chain of events shook the confidence of the financial market beginning Mid-September which was already simmering to burst any time by the collapse of the housing market in the US;

- **Once such huge companies reached the brink of collapse, the crisis spread across the international financial markets like a wild fire.**

- Therefore, as the following chart shows, the collapse seems to have developed as follows: relaxed money supply → strong housing demand → sub-prime mortgage → Mortgage based Securities (MBS) → Collateralized Debt Obligations (CDOs) → derivatives → Leverage Buy Outs (LBOs) → default → financial crunch → financial crisis .
- Clearly the initial core culprit is sub-prime lending which Gylfson defined as “selling mortgage loans to people with no jobs, no income, no money to put down, and no means of paying back”.

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- **This all shows that the Market economy got drunk in which the hangover is unfolding. A prime example of this madness is found in one investor (a certain B. Madoff in which he skimmed \$50 billion from customers using a Ponzi type of game!).**
- **Ultimately, as A. Shah (October 5, 2008) noted, the “The extent of the problem has been so severe that some of the world’s largest financial institutions have collapsed. The government of wealthiest nations in the world have resorted to extensive bail-out and rescue packages for the remaining large banks and financial institutions”.**

- **'Let me cut to the chase' as they say and let me just summarize it as follows: Ignoring what happened to specific companies and individuals, it has affected the financial markets of national economies across the world, albeit at different degrees. In short, it seems it is much more difficult to find unaffected country in Europe, Asia and Latin America than the converse. To name a few, among the countries whose stock markets has either been partially or mostly collapsed, needed BOP support abroad, or faced a serious financial meltdown include: in the AMERICAS: ARGENTINA, BRAZIL, Chile, CANADA, MEXICO, the US;**

- **In Asian-Pacific: AUSTRALIA, CHINA, HONG KONG, JAPAN, MALAYSIA, NEWZEALAND, SINGAPORE, SOUTH KOREA and India;**
- **In Europe: AUSTRIA, BELARUS, BELGIUM, DENMARK, ESTONIA, FRANCE, GERMANY, GREECE, HUNGARY, ICELAND, IRELAND, ITALY, NETHERLANDS, NORWAY, POLAND, PORTUGAL, RUSSIA, SPAIN, SWEDEN, SWITZERLAND, UK and UKRAINE. And even in the MIDDLE EAST, (particularly Saudi Arabia) haven't been immune from the crises, albeit with less severity than that of Europe, mainly because they were some of the lenders.**

- **Therefore So far: by recent count, as the Guardian reported, according to the Bank of England “market mayhem has left the world's financial institutions nursing losses of \$2.8 trillion”.**
- **‘And between the first half of 2007 and end of 2008, between 25 to 50% of the value of assets on the world stock exchanges has been wiped out’.**
- **More ominously, since March 2008, major investment banks and major integrated global banks and other financial institutions have been threatened with collapse. ‘Citibank, the US’ biggest bank, got \$27 billion injection from foreign sovereign funds. UBS, the world’s fifth biggest bank, got \$ 37 billion capital injection from similar sources’.**

1.2. The Real Economy

- And what has been the economic impact so far? Since what is happening globally is clear, let me just highlight the following general points:**
- Global economy is in recession;**
- Particularly, the US, Europe, Japan and many industrialized countries are hard hit;**
- But even the relatively strong emerging economies (like that of China and India) will contract by some percentage points. For instance, China and the Middle Eastern oil exporting countries are revising their growth prospects downwards for 2009.**

It has to be noted that:

- **ILO estimates 'unemployment is expected to increase by 20 million in 2009'.**
- **The number of jobs lost in the US in 2008 is 2.6 million, in November 2008 alone 533,000 jobs were lost and still continuing in 2009.**
- **The high unemployment figures do not include the recent layoffs;**
- **This number will swell if and when the layoffs by auto manufacturing companies materializes, estimated to be about 3 million in the US alone.**
- **Even in China the number of factories that are closing and the increase in unemployment due to the decrease in exports is huge.**

1.3. Any Theory as a Guide?

- Not many economists predicted the magnitude of the crisis;
- most economists predicted this will be an easy recession and recovery will start by July-August of 2008.
- No comprehensive theory to explain the financial crisis.
- For brevity, the scanty theories of financial crisis that we have might be grouped into three interrelated categories: World Systems Theory, Minisky's theory and Coordination Games based theories.
 - i. The World Systems Theorists (Andre Gunder and Immanuel wallerstein, for instance), and the Minisky Theories essentially (with some variation in details) argue that 'financial fragility is a typical feature of any capitalist economy' as it moves through the business cycles'. In particular, firms change their attitude towards risk as they go through the various stages of the business cycle from 'hedge finance' (conservative risk) to 'speculative finance' (moderate risk) and finally to Ponzi financing as their confidence increases with an economic boom.

ii. Coordination Games, on the other hand, are the modern theories which use mathematical models that emphasise that financial crisis result from 'feedbacks which are explained as herd mentality, contagion, self-fulfilling prophecies (as in Krugman and Fieldestein for the exchange rate speculative attacks)'. Their defining feature is that they are caused by some dis-equilibrium and an overreaction by economic agents.

2. What has been the policy Response so far and will it work?

2.1 The Policy Response

World leaders initially met in Beijing to address the issue – an interesting choice of venue to fix the market system;

- The Fed, China, Japan and ECB alone have now infused close to \$7 trillion worth of financial help to markets. The deflation in all markets is so severe that those infusions pale compared to the \$25 trillion wiped out from world markets in the last year.**
- By October 30, the International Monetary Fund offered as much as USD 100 billion in a new kind of loan to countries that are battered by the financial crisis, making available new cash to help ease the world credit crisis.**

- **At a global level, there is a more aggressive stand, initiated by the UK and France, to remedy the financial structure by either re-organizing the WB and the IMF or coming up with a new (Bretton Woods II ?) or some financial architecture. The so called G20 countries met and declared their intentions to do something about it very soon.**

- **In the US, the new administration is proposing even much more stimulus packages in excess of the \$700 billion approved in the fall; It appears that the stimulus package is considered so vital, it has become the preoccupation of the new administration. In short, it seems, any thing could fly in the US public and the Congress as long as it is couched in terms of helping the financial crisis.**
- **2.2. WILL THE BAILOUT Policy WORK?**
- **On the whole, the jury is still out but the consensus and the economic events since the announcements of the bailouts seem to be:**

- **(a) There seems to be a consensus that the bailout should be done for the simple reason that “the cost of not doing is higher than doing so”.**
- **(b) that it may help, at least in the short-run, by boosting confidence in both the financial markets and the business community;**
- **(c) but not likely in the long-run. Therefore, while most agree that it has to be done, but its efficacy in limiting the damage on the economy is in question. To sample a few view points:**

- **Stiglitz believes, “The very assumption that the rescue plan has to help is suspect. After all, the IMF and the US treasury bail-outs for Wall Street 10 years ago in Korea, Thailand, Indonesia, Brazil, Russia and Argentina didn’t work for those countries although it did enable Wall Street to get back most of its money. The taxpayers in these other poor countries picked up the tab for the financial markets’ mistakes’.**

- **Stiglitz continues, “The bailout is seen as a bailout for the culprits while the ordinary person would be left to pay for their folly. (This assumes) that you throw enough money at Wall Street, and some of it will trickle down to the rest of the economy. It’s like a patient suffering from giving a massive blood transfusion while there is internal bleeding; it doesn’t do anything about the basic source of the haemorrhaging, the foreclosure problem” (Stiglitz).**

“The immediate focus should be on addressing the recession. And the Fed seems to be doing its job”. R. Lucas. The market ‘guru’ supporting a bail-out!

In short, it's a total unmitigated disaster. The only question is “when will all the layoffs appear everywhere?”. If we go back to the last great world depression in the 1930's, all the layoffs started in earnest about a year after the financial crashes. By 1933, the US had over 25% unemployment, and stocks had fallen 90%.

- **So these are some of the views on the world economic situation.**
- **The Unfortunate thing is that, in the process, both the people and the market have lost confidence in themselves. This may suggest that the economic pundits who dominated both the wall and the main streets may have to be replaced by shrinks who are likely to know more about herd mentality and contagion effects than the numerically literate crowd in the two markets.**
- **So far we have seen the financial and economic impacts of the crisis, but what explanations do economists give as fundamental causes for this?**

3. What fundamental factors caused the economic Imbalances?

- **At a diagnosis level, whether it is viewed as a temporary market correction or a system disintegration of the market system, depends on the school of thought you subscribe to. But interestingly, Minsky's Post-Keynesian predictions seems to be sensible in this case when he stated some 30 odd years ago that: "Stability is paradoxically destabilizing...good times encourage experimentation and excessive risk-taking, ending up with a bang".**
- **Be that as it may, the current crisis is attributed to have been caused by three imbalances:**

a. Current Account Imbalances:

- **'A decade ago, the Asian financial crisis of 1997 was caused by the gaping current account deficits of emerging countries mostly financed by private capital inflows that gushed out as quickly as they pushed in. Today, the export surplus and excess savings in other parts of the world – most notably the Asian countries – support the consumption habits of the US household and government'.**
- **In 2006, US public debt (excluding government's intra-governmental debt of another \$3.8 trillion) 'stood at \$5 trillion of which \$2.2 trillion (44%) was held by foreigners. Foreign central banks with huge reserves owned 64% of this \$2.2 trillion. The country holding the most US public debt was Japan (\$612 billion), followed by China (\$420 billion). This does not include the private debt of households in the US totalling \$12.8 trillion (\$9.7 trillion in housing loans and \$2.4 trillion in credit card loans)'.**

- **'Corporate debt was \$9 trillion and financial sector debt was \$14.2 trillion (Hodges, 2007). According to the same report, foreign investors accounted for 46% of US treasury bonds, 27% of corporate bonds, and 14% of government agency bonds. In 2007 the US CA deficit of \$790 billion was 93% financed by the combined CA surpluses of China and Japan, Germany and Saudi Arabia (Economist 2007e).'**
- **Note that this suggests the official and private debt per capita in the US is about \$53,000.**
- b. **The second imbalance is "Wealth and Income Imbalance"**
- **More saving or less consumption in the emerging economies while the converse is true in the developed countries. BUT Why? One view is, it may be 'because there aren't many profitable investment opportunities or the bond markets are not well developed';**

- **But it may also be due to skewed income distribution. Hence 'income and wealth inequality in these countries has worsened. For instance recent studies in China has shown that income inequality as measured by the Gini coefficient rose from 0.310 to 0.415 (equivalent to that of the US in 1999) between 1985 to 2001 and it is likely to increase due to the bias against the rural area. The inequality is also evident from the disproportionate share of income – most of it going to capital rather than labor – according to WB estimate the share of China's GDP to labor fell from 53% in 1998 to 41% in 2005'.**
- **The excess wealth must be re-invested. Therefore, the billions and trillions of excess income of rich individuals, institutions, and sovereign states has no option but to chase for higher yields. Financial institutions and innovations exist to meet these demands, hence, in the midst of today's credit crunch, there is excess liquidity in the financial system looking for profitable investment opportunities. For example, sovereign states with an estimated \$3-\$4 trillion of funds are desperately seeking higher yield.**

c. Imbalance between Finance and The Real Economy

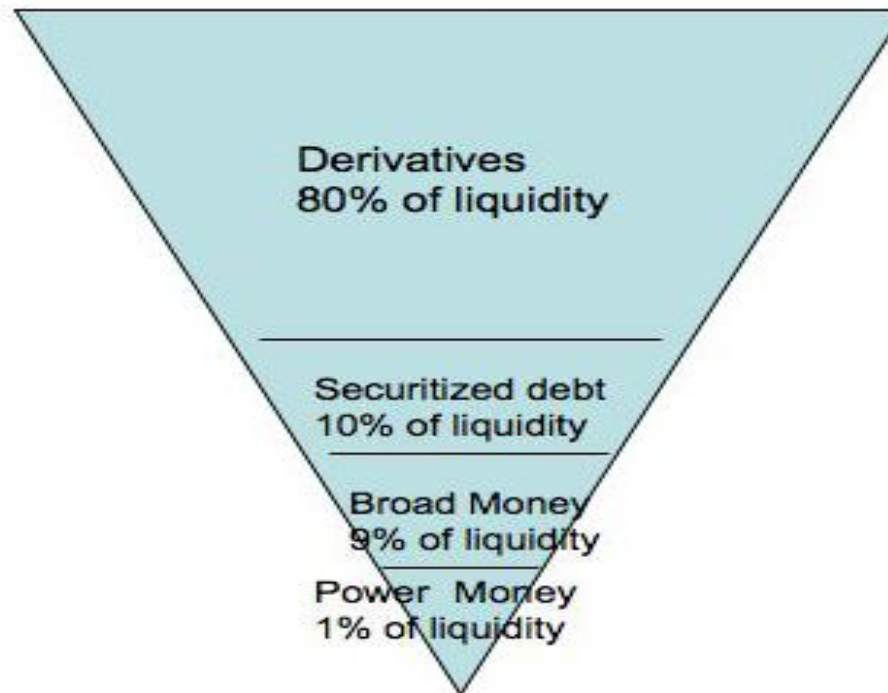
- **This is the most serious of the imbalances that have taken place. The volume of financial investment has dwarfed the value of productive investment worldwide as various indicators show;**
- **'The ratio of global financial assets to annual world output used to be about equal (109% in 1980), but by 2005, it was three times larger (316%). And in terms of value, global financial assets were \$140 trillion while total world GDP stood at \$48 trillion in 2006 (1:3).'**

GDP Share of US Financial Sector (1860-2008)



- **Another indicator is the basic compositions of the financial sector has dramatically changed:**
 - **'Turnover in traditional exchange markets (spot, forward and swaps) increased to an unprecedented level of \$3.2 trillion a day, while activity in the over-the-counter derivatives markets reached \$2.1 trillion per day. This is compared to the volume of world trade which stood at \$12 trillion per day'.**
 - **'The traditional idea of M1, M2 and M3 as the core liquidity is no longer valid, given the financial innovations that have resulted in an explosion of other forms of liquidity, like derivatives, that have truly escalated leverage'.**
- **According to a recent study high powered money (M1 and M2) constituted only 1% of the global liquidity pyramid while broad money and securitized debt constituted 9% and 10%, respectively. Derivatives constituted 80% of the global liquidity**
- **The global liquidity market is estimated at \$607 trillion or 12.5 times global GDP. Given this scenario, central banks have little control over the global liquidity market. It seems we have reached a stage where the financial market affects or perhaps dictates what happens in the economy---instead of the other way round.**

Figure 1 Global Liquidity Market \$607 Trillion



- **In Sum, therefore, both the financial meltdown and the economic downturn, albeit big, suggest that it is a reaction to the excesses observed in the market rather than a collapse of the system. This is just like a drunk person who may negatively affect his health (and some times endanger himself) but after while s/he shakes off the hangover and become the good self.**
- **Hence this seems to be a big correction and not a disintegration of the market.**

II. What are the Likely Impacts on Botswana? And Africa?

- **There are different strands of opinion regarding the likely effects on Africa in general.**
- **But there seems to be a consensus on the following points:**
- **First, because of Africa's generally weak financial integration with the rest of the global economic system, it is believed that the financial sectors of many African countries (except slightly that of South Africa and few countries) will not be directly affected by the unfolding crisis.**
- **Second, the economic effects that are likely to follow (if and when they do) are going to be severe because of the vulnerability of African economies to even minor external shocks;**
- **Third, the shock through which they transmit to African economies is not mainly through the credit crunch and lack of liquidity as observed in advanced and emerging economies but through the recession that follows this crisis.**

- **As the World Bank Chief Economist for Africa S. Devarajan noted: the channels through which the crisis would have an adverse impact on African economies as recession in developed economies spread will be indirect, which include:**
- **“First, a slowdown in private capital flows**
 - **negatively affect economies that had been relying on these flows to finance much-needed investment, particularly infrastructure investment. Already Ghana and Kenya have postponed sovereign bond issues worth about \$800 million,” he said.**
- **“Second, commodity prices are falling - hurts exporters and helps importers.” UNCTAD adds “Commodity-dependent economies are exposed to considerable external shocks stemming from price booms and busts in international commodity markets”. Botswana is a prime candidate in this case.**

- **Third, tourist revenues are likely to substantially decline as recession in developed countries deepens.**
- **The wealthier ones (MICs, like Botswana and South Africa) who do have some exposure to the rest of the world, of course, may face some problems of financial crunch as well in addition to the secondary economic effects.**
- **Consequently, as is the case for the developed countries, the World Bank has downgraded the growth prospects of Africa from 7.9% to --0.1% for 2008 and from 6.9% to -1.1% for 2009 (Table below).**

World Economic Outlook projections (IMF-
the last two years are revised values)

World	2006	2007	2008	2009	2008	2009
USA	5.1	5.0	3.9	3.9	-0.2	-0.9
Euro area	2.8	2.0	1.6	0.1	0.3	-0.7
UK	2.8	2.6	1.3	0.2	-0.4	-0.1
Brazil	2.8	3.0	1.0	-0.1	-0.8	-1.8
Russia	3.8	5.4	5.2	3.5	0.3	-0.5
China	7.4	8.1	7.0	5.5	-0.7	-1.8
India	11.6	11.9	9.7	9.3	-	-0.5
Sub-Saharan Africa	9.8	9.3	7.9	6.9	-0.1	-1.1
Middle East	6.6	6.9	6.1	6.3	-0.5	-0.5
ASEAN-5	5.7	5.9	6.4	5.9	0.2	-0.1
World trade volume*	5.7	6.3	5.5	4.9	-0.1	-1.0
APF/MRDE	9.3	7.2	4.9	4.1	-1.2	-1.9

4. Is Botswana Likely to 'Duck' the financial Blow?

• Not likely, it may escape with a minor scratch in its financial sector but its economic sector will likely be seriously bruised; This is because:

- it is heavily dependent on export revenue (about 2/3 of government revenue) comes from exports;**
- FDI: many projects are in the implementation process partly financed by FDI;**
- Tourist Revenue: is a significant foreign exchange earner (about 5% GDP in the last 5 years);**
- Most of the destinations for its exports (about 75%) are the US, Europe and Japan which are direct victims of the recession.**
- Therefore while no more recent and solid numerical evidence is available for Botswana since the financial meltdown, that it has adversely affected the performance of the economy is not**

- On the bright side its relatively healthy foreign reserve position (about USD 8 to 9 billion or 65 to 70 billion Pula) and a decline in oil prices have probably mitigated and give some optimism despite the gloomy picture;
- Otherwise, as is the case in many export dependent economies, the preliminary evidence suggests that both the real sector and to some extent the financial sector are somewhat negatively affected by the crisis;

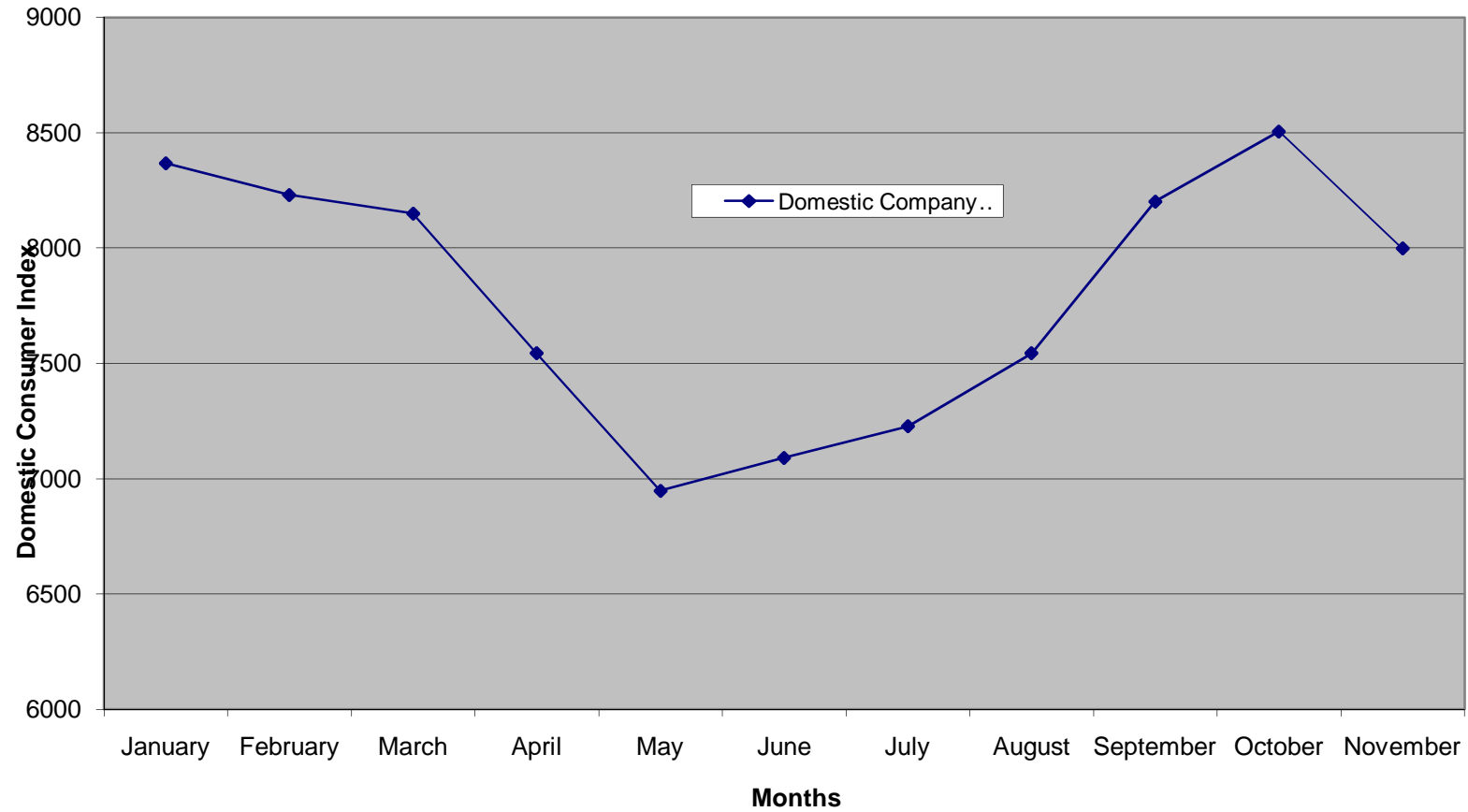
- Specifically, there is some evidence that the last two months have witnessed a down turn in some aspects of both the financial and economic sectors of the economy.

4.1. What does the Preliminary Evidence Say?

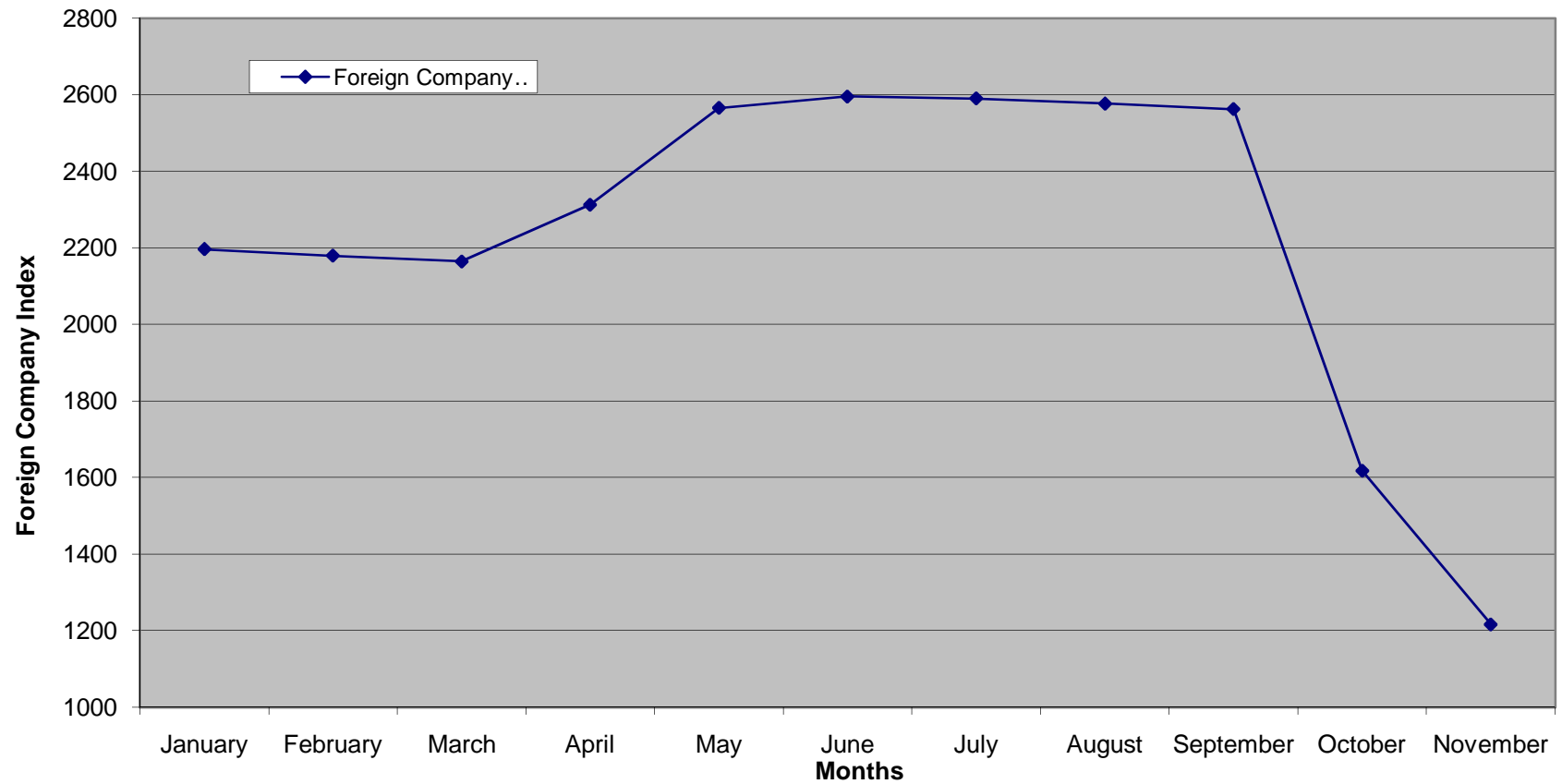
A. The Picture in the Financial Sector

- As the following graphs show, the stock markets of both domestic and foreign firms show a decline since September 2008;
 - In particular, the index for foreign firms has noticeably declined since September as was the case in the industrial countries.
 - Understandably, the index for domestic firms started to decline slightly late and with a smaller margin than that of foreign firms.

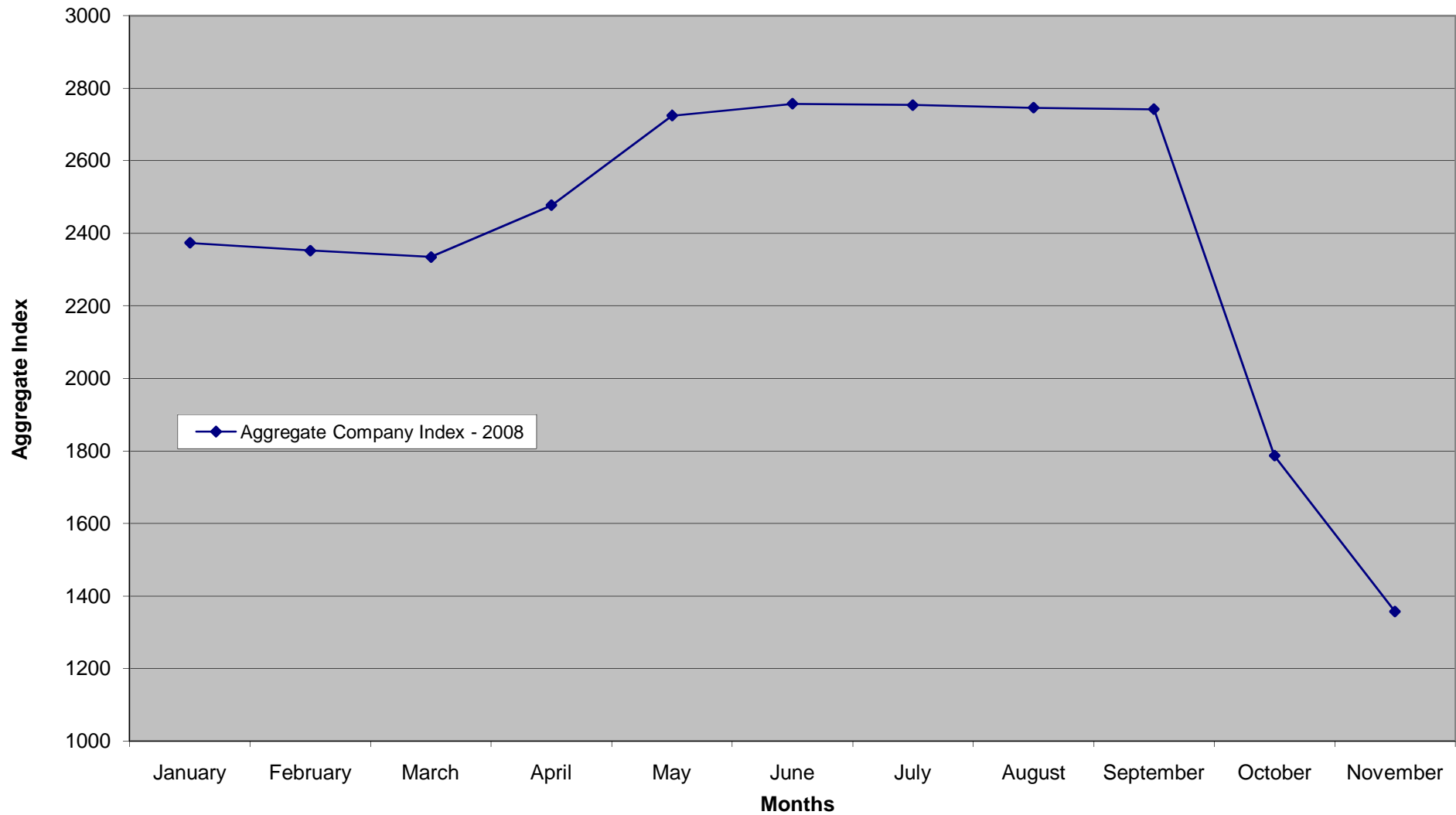
Domestic Company Index, 2008



Foreign company Index, 2008



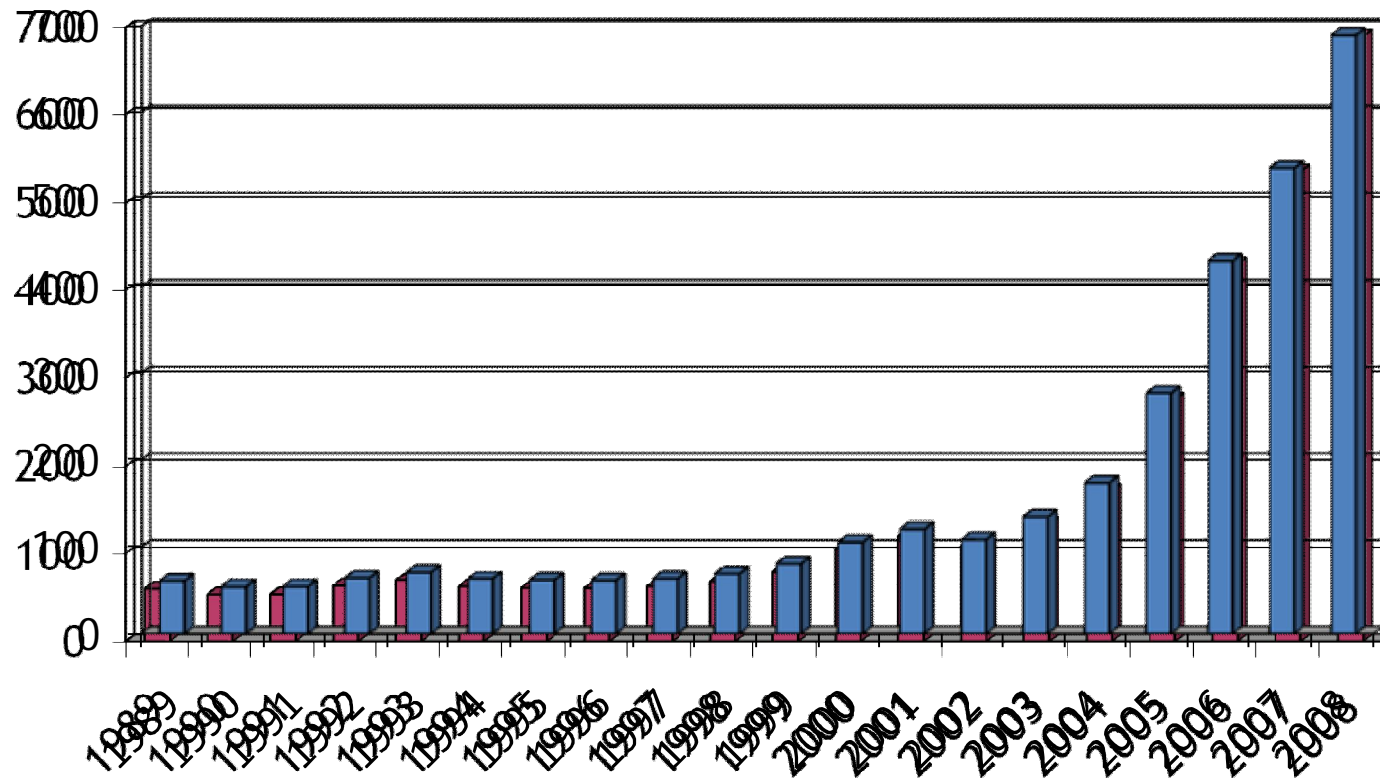
Aggregate Company Index - 2008



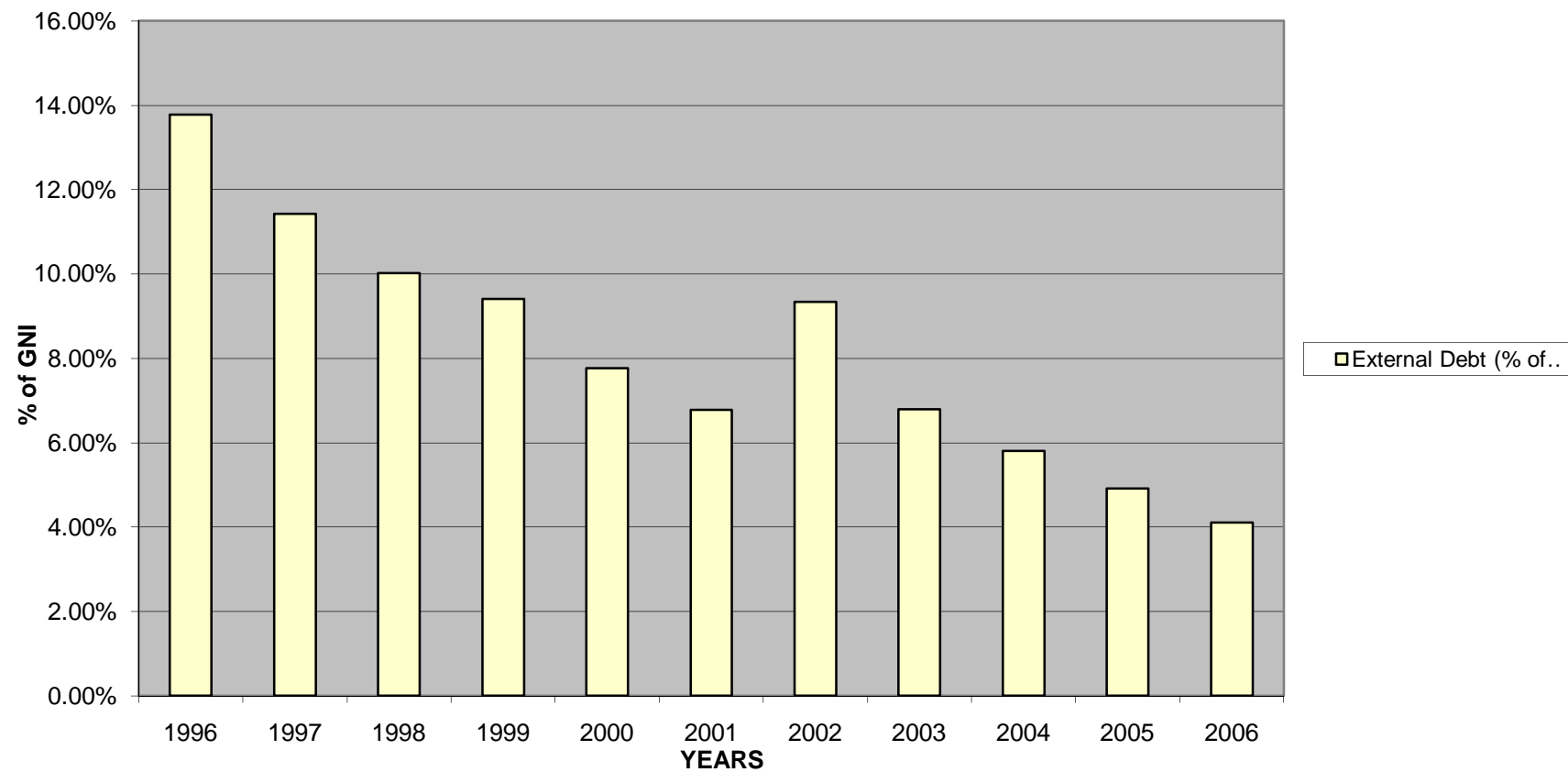
But let's put it all in context. While there have been a downward movements in the financial sector in recent months, Botswana's overall financial structure looks healthy compared to other countries. Let us compare some ratios for both some selected countries and Botswana as data permits.

- (i) External debt, (ii) Bank assets, (iii) market capitalization of listed companies, (iv) Central Bank foreign exchange reserves, and (v) current account balance all as ratios of GDP. As could be seen in the following graphs, in all the cases, Botswana's position has been relatively healthy, for comparable years, even though the data we used is only up to 2006.

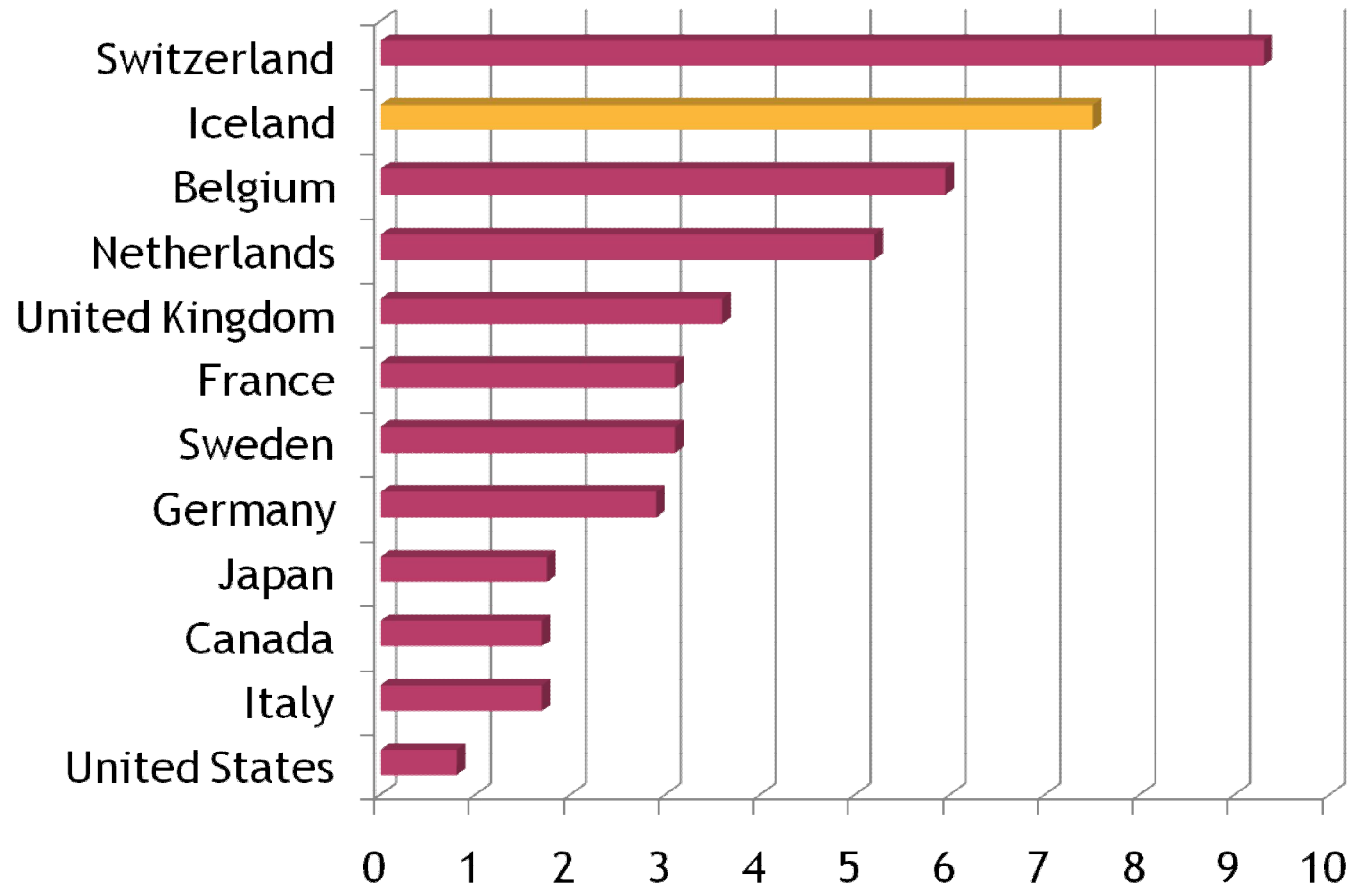
ICELAND: EXTERNAL DEBT 1989-2008 (% OF GDP)



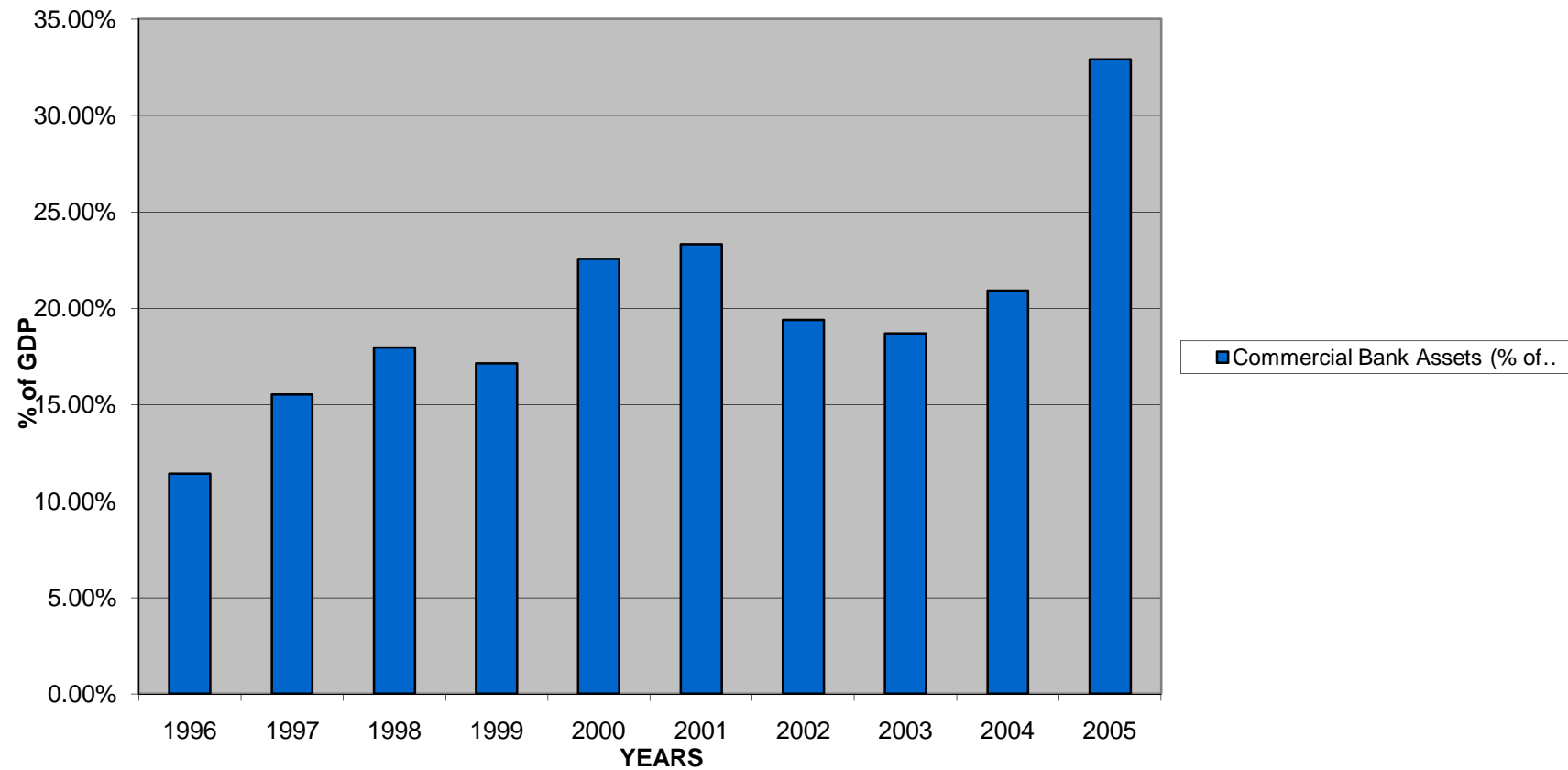
Botswana: External Debt (%GNI)



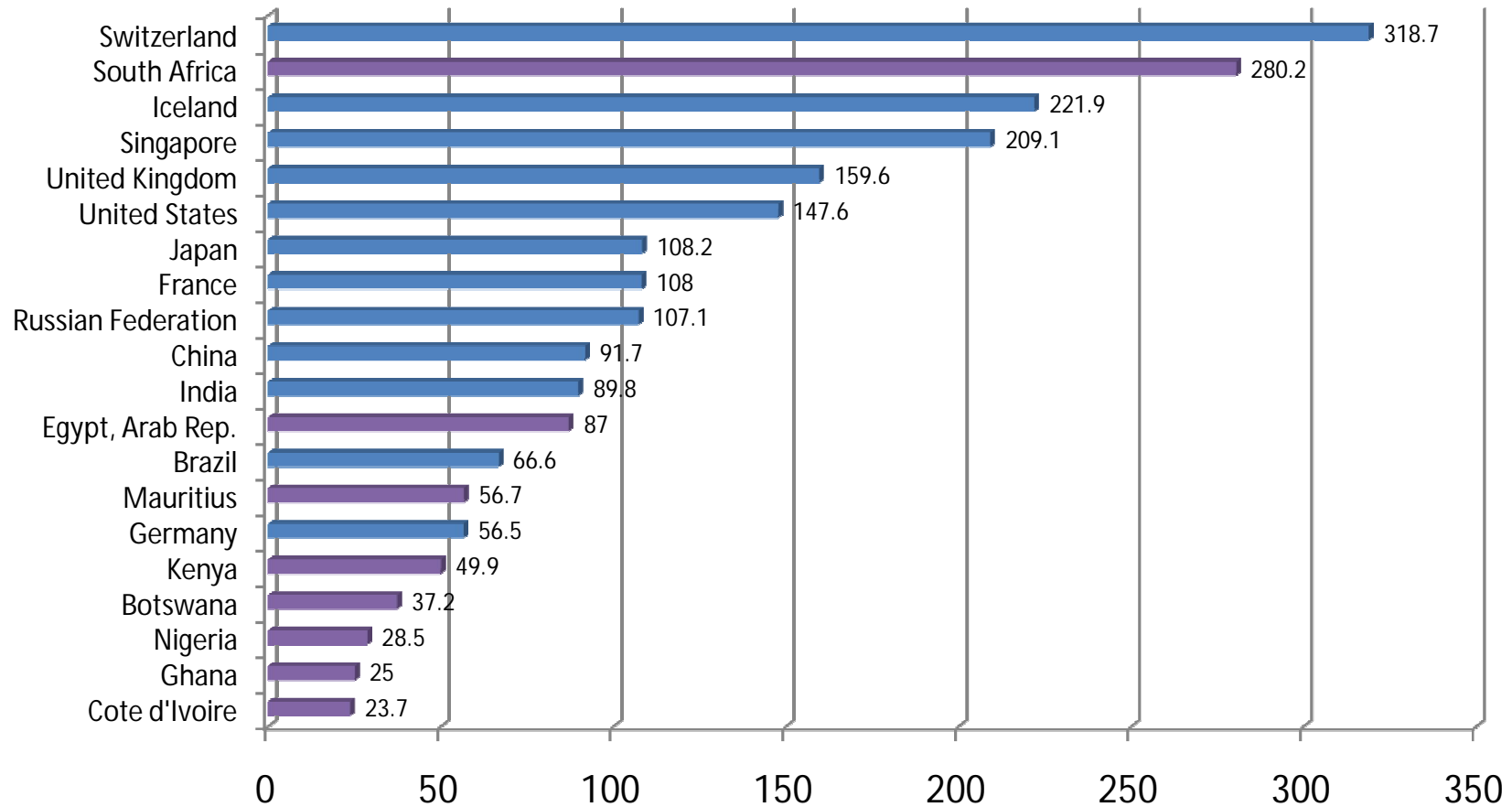
Selected countries: Ratio of Bank assets to GDP 2007



Botswana: Commercial Bank Assets (% GDP)

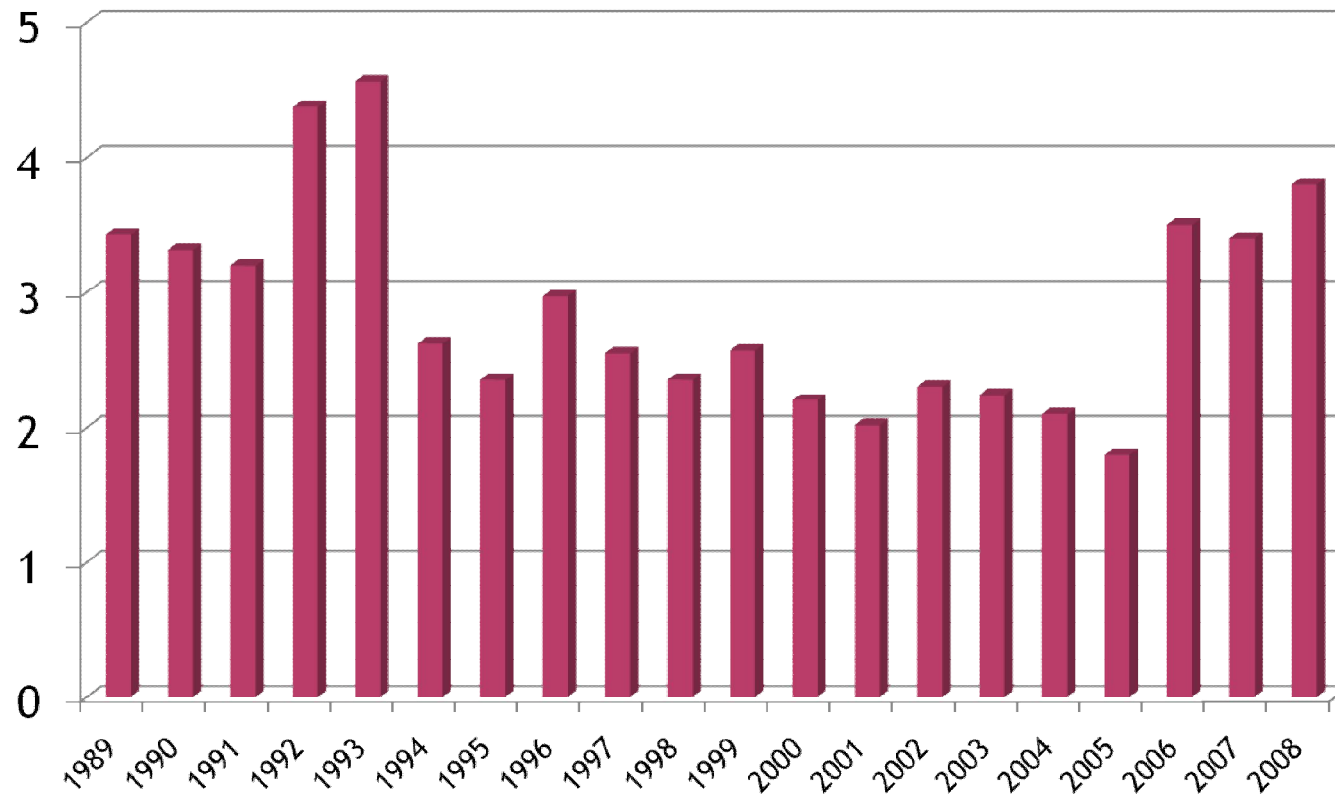


Market capitalization of listed companies 2006 (% of GDP)

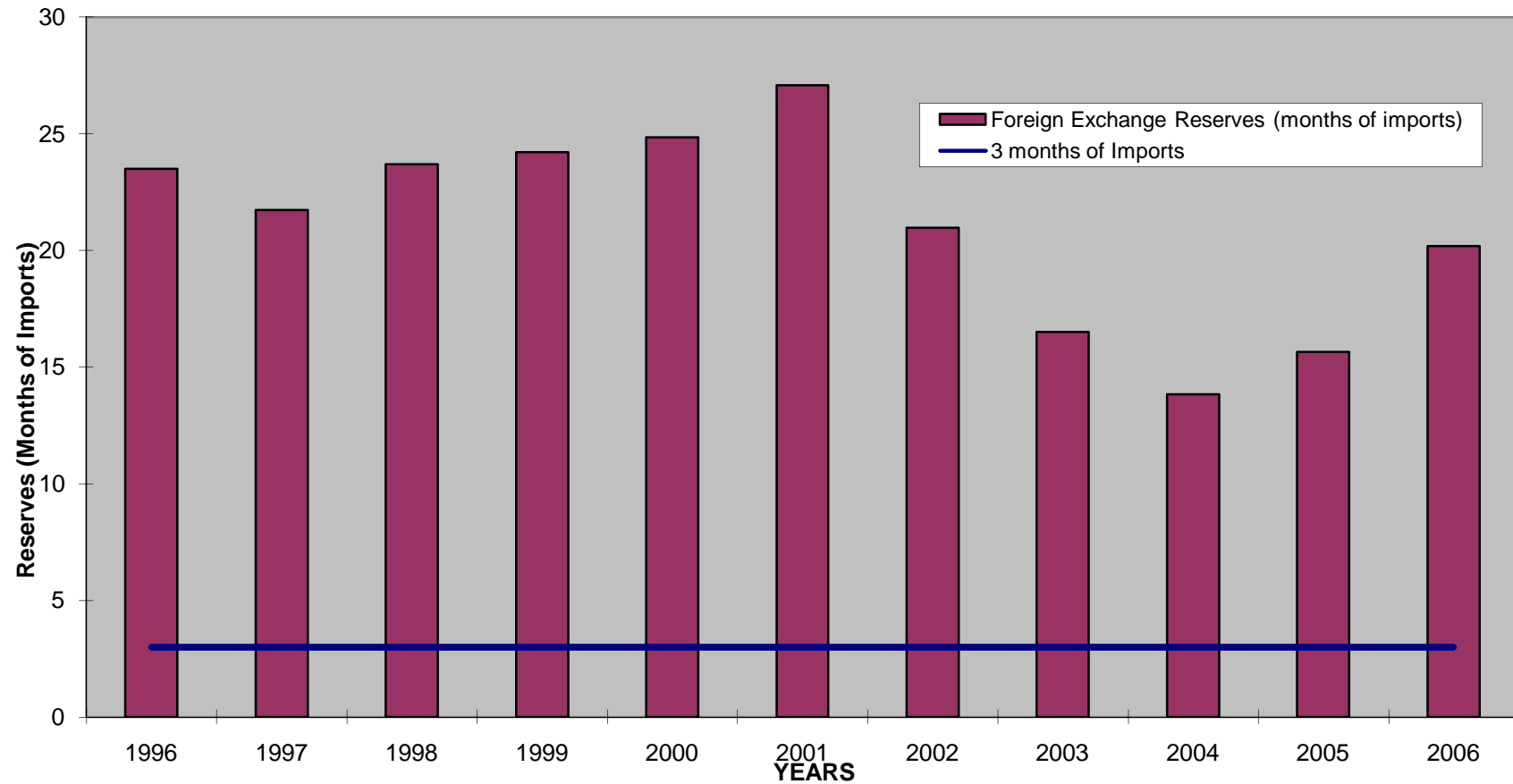


Iceland: Central bank foreign exchange reserves 1989-2008

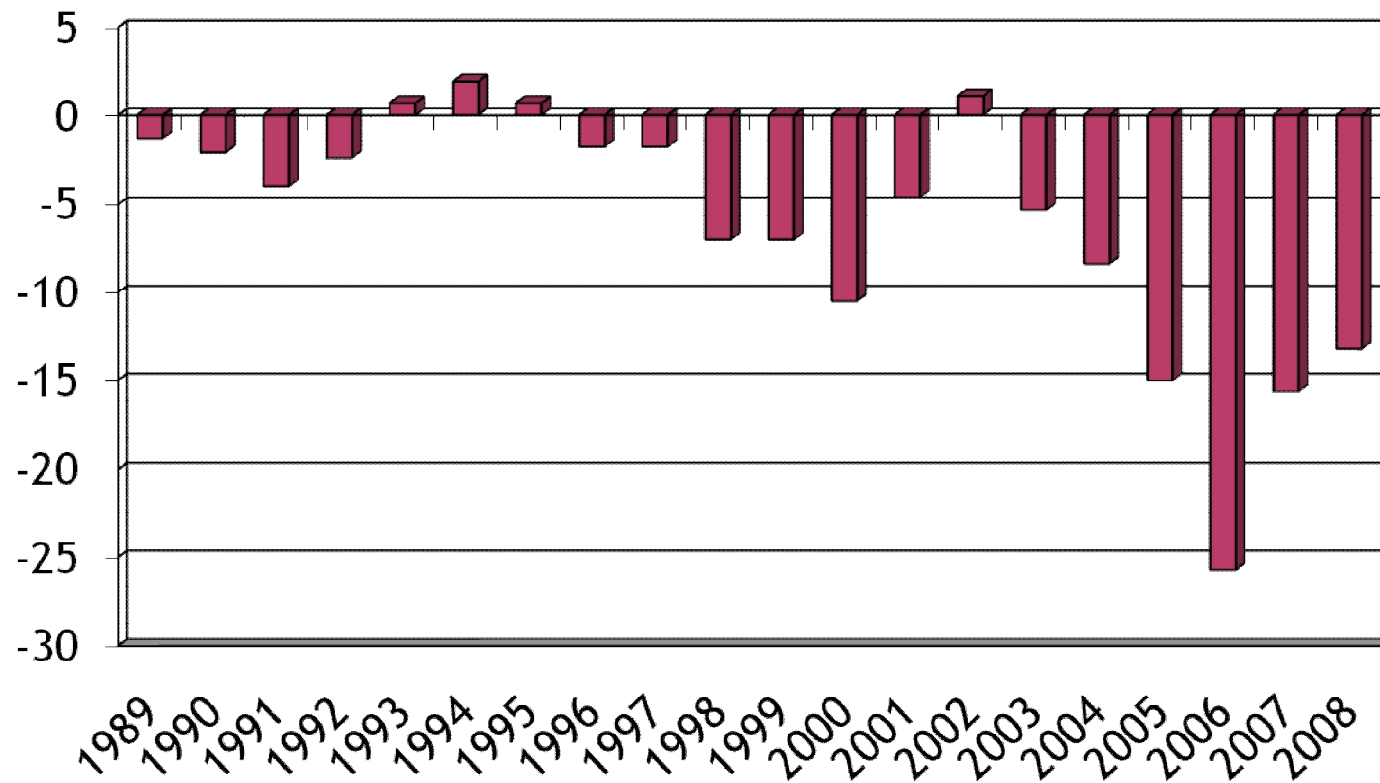
Months of imports



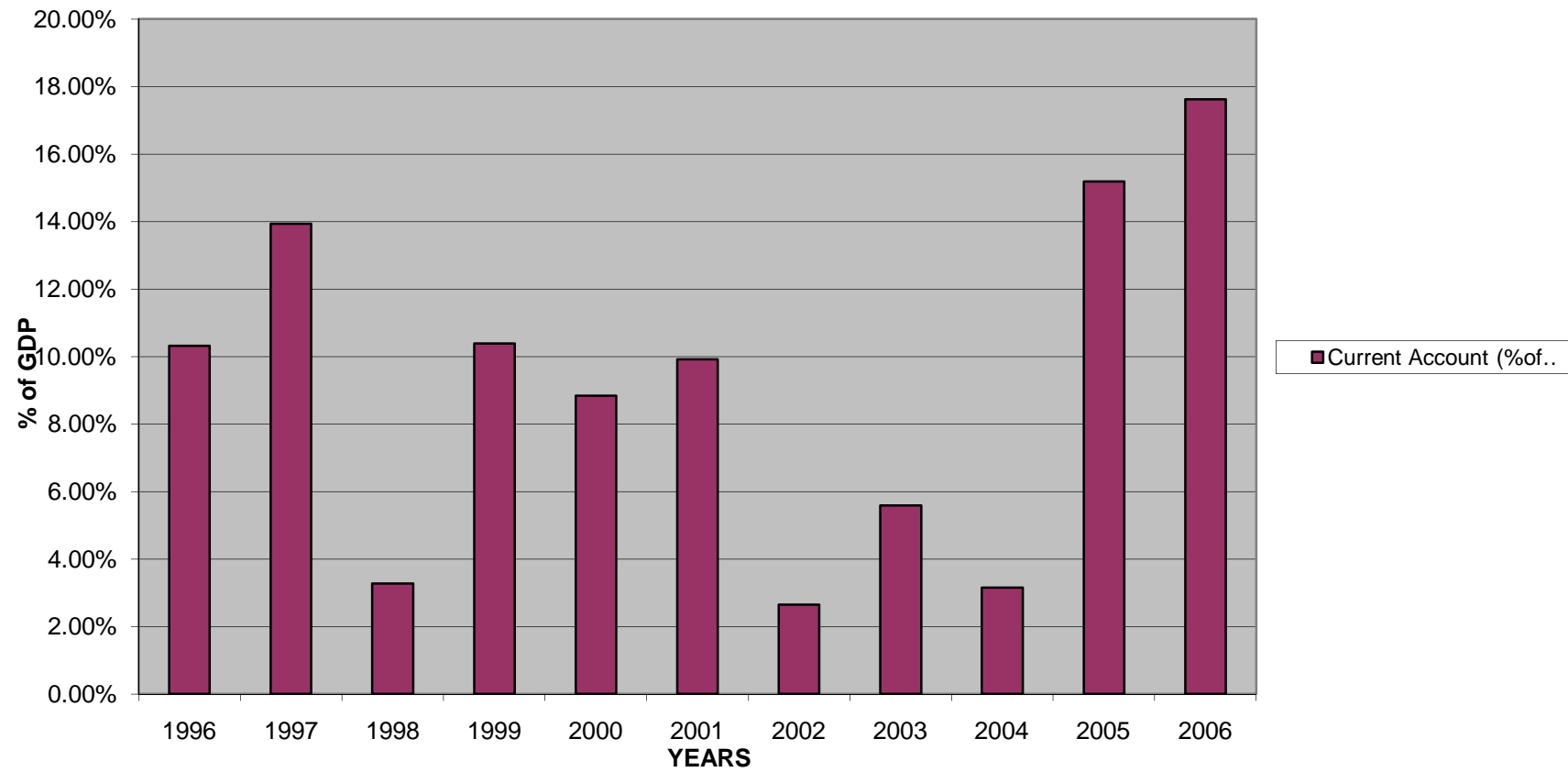
Foreign Exchange Reserves (months of imports)



Iceland: Current account 1989-2008 (% of GDP)



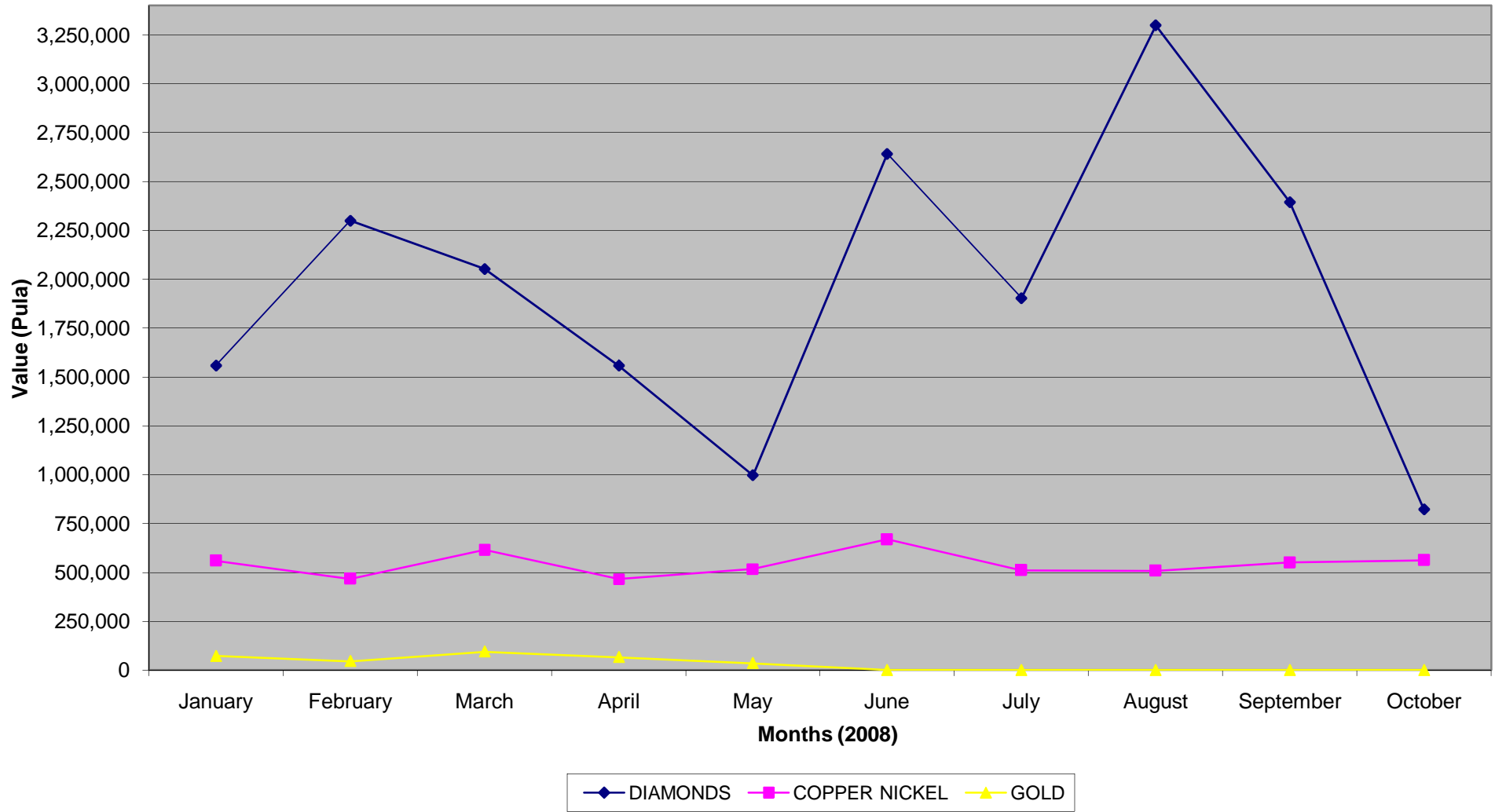
Botswana: Current Account (%GDP)



B. In the real sector

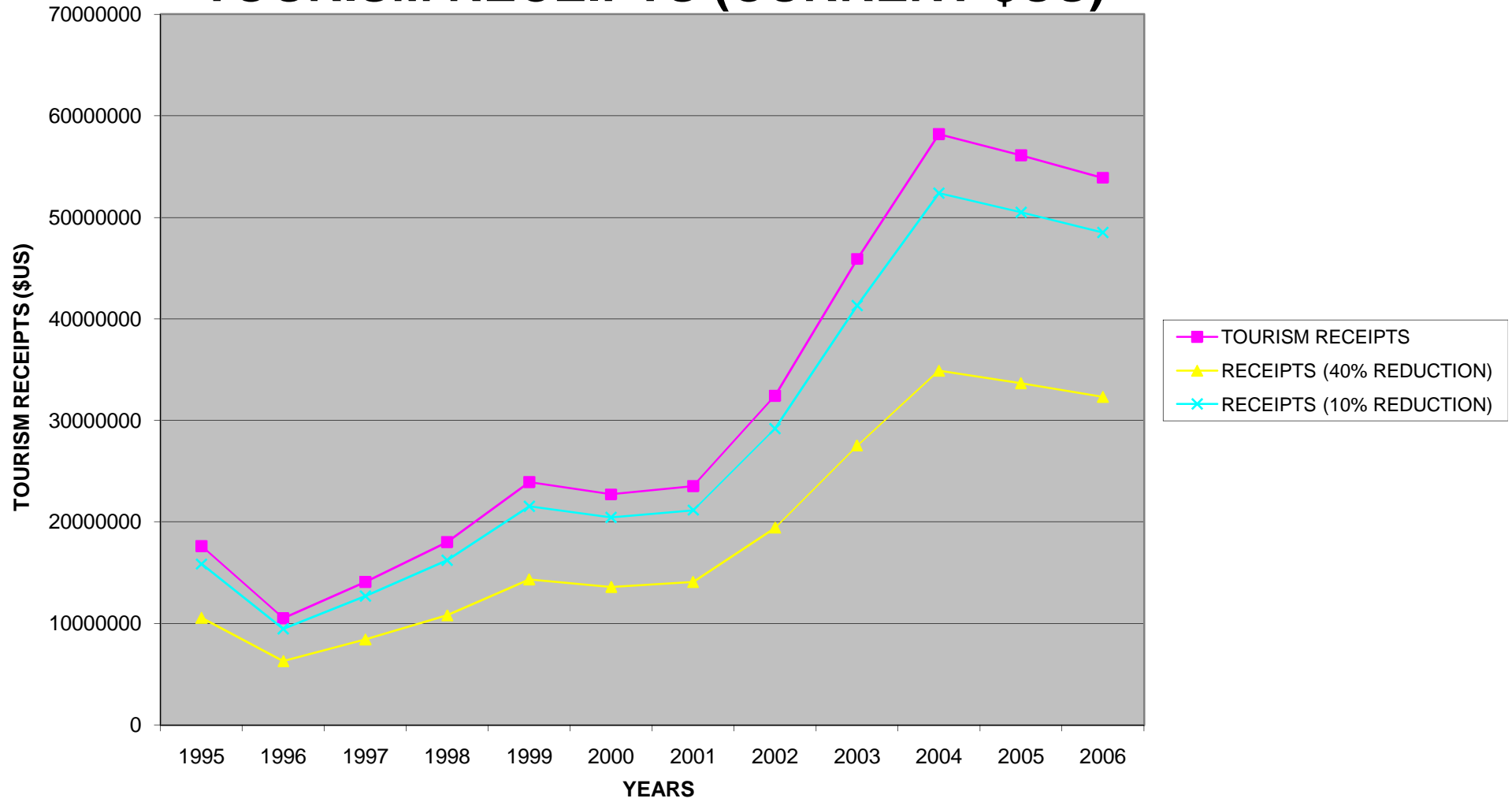
- No very recent data for the real sectors of the economy is available yet, but there are indications some sectors (like the diamond industry and other export sectors) have exhibited some slowdown following the weak demand in the industrial countries.
- Clearly the actual effect, if any, will have to wait until the actual data is gathered for some appreciable time to assess the extent to which recession in developed countries is having an impact on Botswana.
- As the following graph shows, however, the preliminary evidence suggests that the values of the main mineral exports of Botswana, particularly Diamonds, started to decline beginning September 2008. Admittedly, this is a short period of time and hence it could also be due to other seasonal factors. But it definitely seems to coincide with the global meltdown.

VALUE OF MINERAL EXPORTS ('000 PULA)



- Further, no data is readily available, but in all likelihood it is expected that there will be some decline in tourist revenue. Assuming, a best case scenario of only about 10% and a worst case scenario of about 40% reduction in tourist revenue, the contribution of the sector to GDP would appreciably decline.

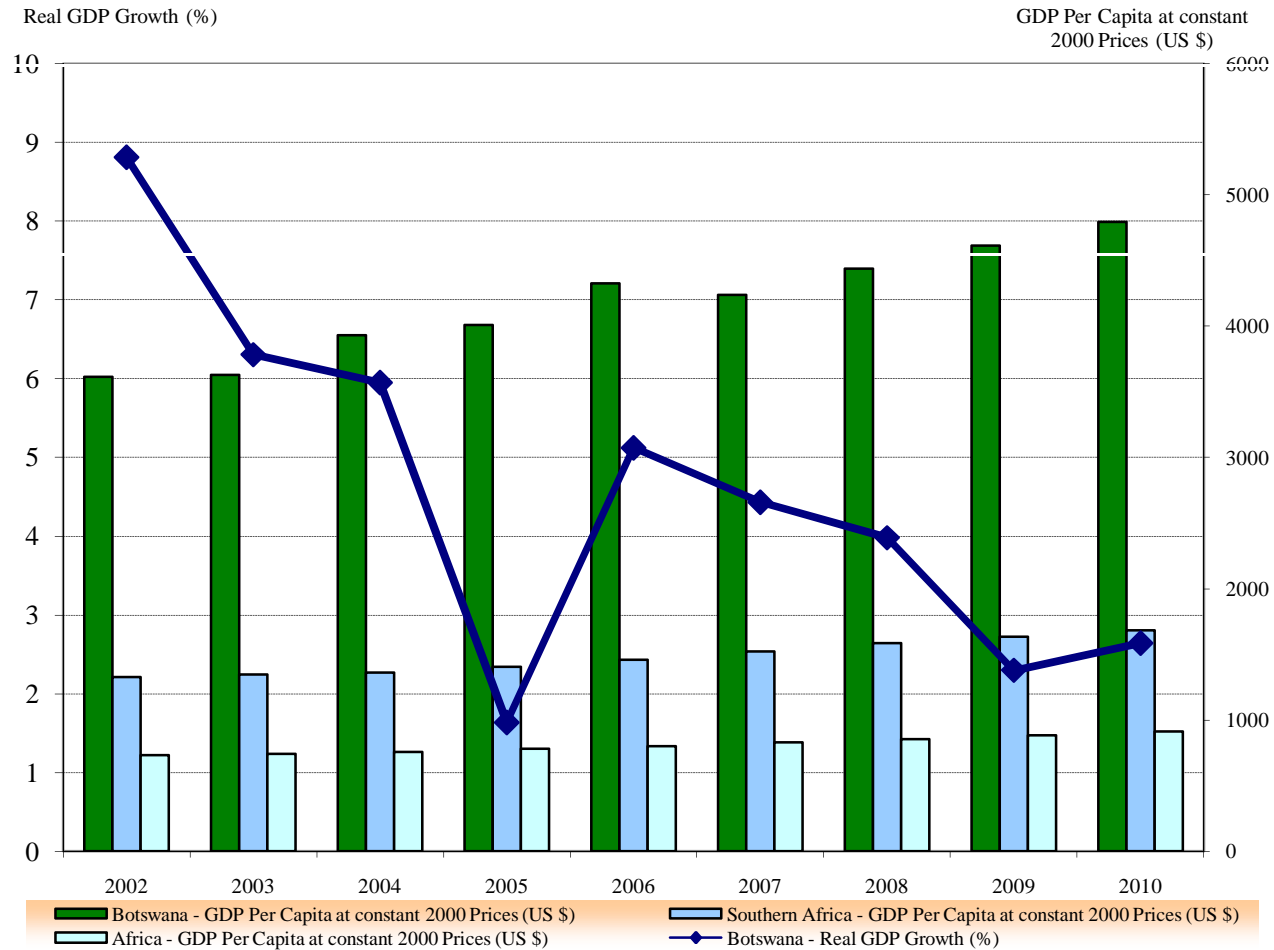
TOURISM RECEIPTS (CURRENT \$US)



- **Other collaborative evidence also suggest a similar decline on the over all performance of the economy. For instance,** the Minister of Finance noted “The impact of the recent financial crisis will be substantial with serious implications for the economy. The main risk to our economy from the crisis is on mineral exports, in particular diamond sales, which started to fall significantly in November 2008..(and) there has been a sharp decline in commodity prices in the past three months for other minerals like copper-nickel and gold. As a result..there will be a slow down in economic growth.”
- Consequently, as reported in local papers, the Minister noted that “the expected substantial reduction in mineral revenue due to the global financial crisis is a cause for serious concern, given that such revenues have accounted for about 35-50% of the total government revenues over the past five years.”

Further, as the following graphs show, preliminary forecasts by the African Development Bank (AfDB) for Botswana's overall economy (as measured by its GDP), also suggests that its growth will decline from an estimated rate of 4% for 2008 to 2.1% in 2009 and 2.3% for 2010.

Projected GDP growth Rates (%)



Demand Composition

	Share of GDP		Growth %, Real			Contribution to Real Growth		
	2000	2007	2008(e)	2009(p)	2010(p)	2008(e)	2009(p)	2010(p)
Gross Capital Formation	31.8	26.9	12.1	9.1	7.2	3.3	2.7	2.3
Public	12.0	7.5	12.5	11.0	9.0	1.0	0.9	0.8
Private	19.8	19.4	12.0	8.4	6.5	2.4	1.8	1.5
Total Consumption	56.2	60.5	3.2	4.4	4.2	1.8	2.6	2.5
Public	25.4	20.2	7.8	7.3	7.4	1.5	1.5	1.6
Private	30.8	40.3	0.8	2.8	2.4	0.3	1.1	0.9
External Demand	12.1	12.6				-1.2	-3.1	-2.4
Exports	53.3	49.5	1.7	-1.5	-0.9	0.9	-0.8	-0.4
Imports	-41.2	-36.9	5.4	6.0	4.9	-2.1	-2.3	-2.0
Real GDP Growth						4.0	2.1	2.3

Source: Central Statistics Office and BIDPA's projections

- **On the whole, therefore, it is premature to precisely know (in quantitative terms) the extent to which the global financial crisis will affect the Botswana economy. The preliminary evidence (documented above which by and large is based on only few months recent data and educated guesses), however, seems to suggest that the economy is unlikely to 'fully duck' the blow or even escape with only a small scratch.**
- **The Important question is then, what policy options should one put in place to mitigate if and when a full-fledged 'blow' hits the economy?**
- **Or more specifically, what policies, at what level of sectoral detail and in what sequence should policies be designed and implemented to mitigate such effects?**
- **But fully addressing such questions requires identifying what data sets or information and what policy instruments are available for use before embarking on such an exercise.**

5. Elements of Designing A Coherent Policy

5.1. Pre-requisites

- **Before attempting to design any policy there are few issues that have to be addressed from the outset. These include:**

- 1. Assembling timely, accurate and encompassing data sets on all the variables of interest, particularly related to crisis prone sectors;**

- 2. Based on historical data, assessing the multiplier effects and inter-sectoral interactions (ranging from simple elasticities to multi-sector linkages) to evaluate any actual and/or potential impacts of the global recession on the economy;**

- 3. The designed policy must satisfy two essential objectives: relevance for possible current crises and long-term growth;**

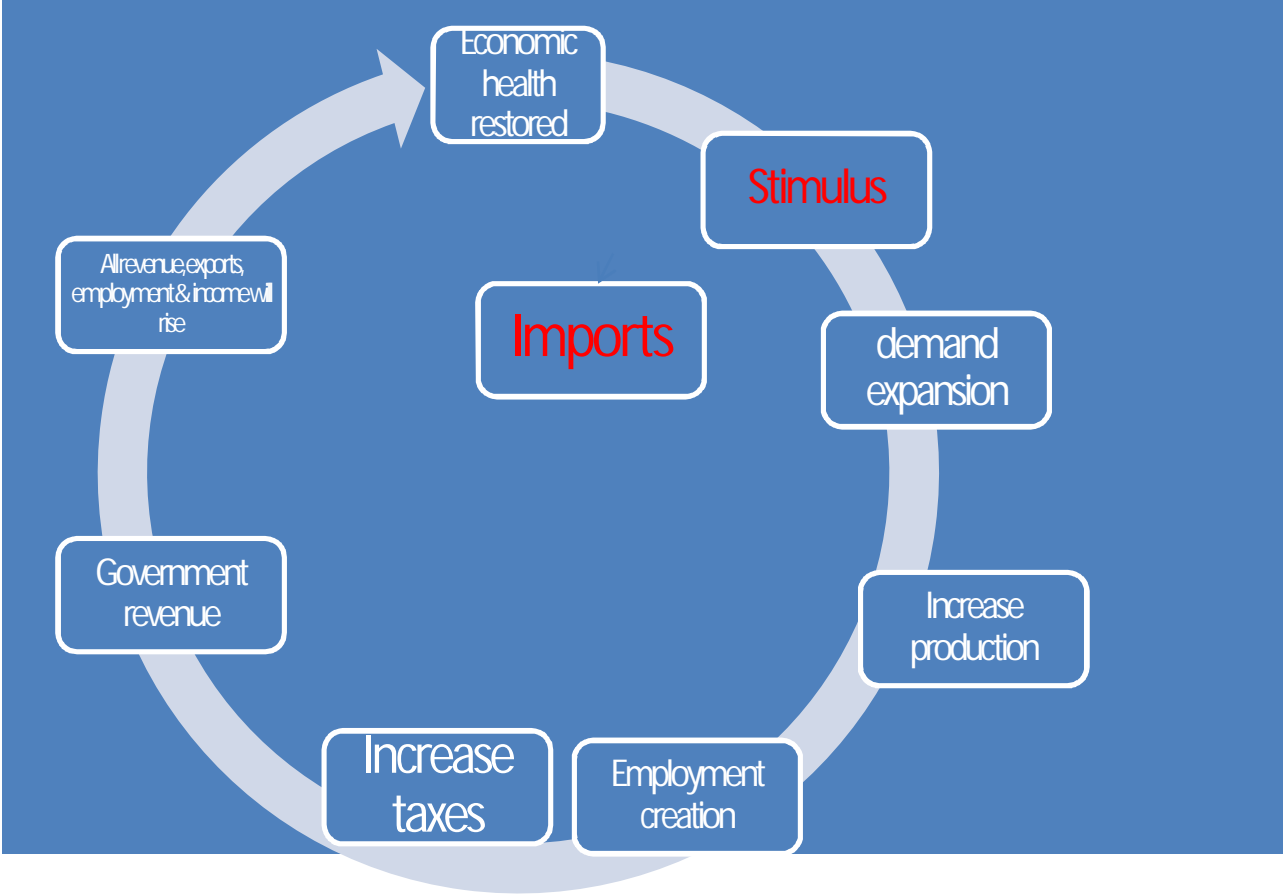
- 4. Once the raw data is assembled and the sectoral forward and backward linkages are established, a thorough assessment of the policy instruments among a menu of choices have to be identified;**
- 5. A detailed assessment of the basic attributes of the economy and its reaction to various policy shocks, particularly emanating from the hard hit countries, has to be examined;**
- 6. The criteria that should be used to select from a catalogue of policy options include: ease of implementation (as measured by procedural and access criteria), relevance to desired impact(s), and possible growth and equity considerations;**
- 7. The policies that should be designed must be coherent, reinforcing each other and anchored on the essential characteristics of the Botswana economy;**
- 8. All policy frameworks must be designed to address a plausible range of scenarios and a time frame that distinguishes between the short-, medium- and long-term performance of the economy;**
- 9. Special attention must be given to the sequencing and size of the shocks and possible policies to be implemented so that they will have the desired effects;**

10. In short, before designing and implementing policy, the following and similar questions have to be considered by relevant bodies:
- a. **How much and where are Botswana's pension, foreign reserves, and private stocks invested abroad? And what is the state of those investment firms abroad? How likely are they to be affected?**
 - b. **What is the likelihood of the employment lay offs by firms who have subsidiaries in Botswana to affect branches here, if any?**
 - c. **Exactly by how much are Botswana's exports likely to decrease (both in volume and price) due to the global recession?**
 - d. **By how much is the tourism industry to be affected due to the recession? What about FDI flows?**
 - e. **How will these affect the foreign reserve position of the country both in the short- and medium-run to withstand the storm without serious deterioration? How long and in what scenario is BOP surplus to be maintained?**

The answer to these and similar core questions will determine both the extent of the economic effect of the recession and pave the way for a coherent, sound and effective policy response by policy makers. It is only then, and only then, could one attempt to implement appropriate policies to fend off the adverse effects of the crises and its follow up – economic recession.

5.2. Some Pitfalls of policy making

-As a pre-caution, the temptation to mimic or copy industrial countries' stimulus packages must be avoided because the transmission mechanisms of both economies are likely to be different from each other. For instance, Unlike in the developed economies with a significant share of the economy (2/3 rd in the US) dependent on consumer demand, a stimulus in Botswana → **more demand for imports and less effect on domestic production** → **BOP deficit** → **Depreciation of the currency** → (given inelastic demand for exports) **less export revenue (J-curve)** → **deficit financing** → **possible inflation due to a price-pass through and/or demand pull inflation** → **ultimately may depress domestic production rather than boost it and hence the stimulus may end up boosting domestic demand and not domestic production with all the implications for inflation and BOP position.** Clearly not the intended outcomes!



5.3. What are some of the policy instruments that should be considered

- As noted above, the specific policy choice should only be considered once the above points are ascertained;
- But in general, given the Botswana economy, the following general guidelines could be suggested, as rules of thumb to initiate discussion.
- fiscal policy will be preferred to monetary policy; In particular some serious trimming in fiscal expenditure will go a long way by paying attention to equity;
- Incomes policy is superior to tax policy;
- The focus of policy should be to smooth the transition rather than jump start economic activity, as the latter is determined exogenously.

- **Therefore, all the above factors suggest that, even though the direct effect of the recent financial crisis will be limited, its indirect economic impacts due to the recession abroad is unmistakably serious. What we don't know for sure is the exact magnitude on each sector and its overall effect and the time frame of those impacts.**
- **Before I conclude let me re-emphasise two points: (a) the need for a timely, accurate and sector specific data to examine the depth, scope and transmission mechanisms of the possible effects of the crisis on the Botswana economy. And (b) the focus of any policy must be to search best way possible to manage the transition rather than jump-start the economy, as is the case in other countries.**

— Thank You —