

THE IMPACT OF THE FINANCE SECTOR ON ECONOMIC DIVERSIFICATION: CASE STUDY OF BOTSWANA

L. GABOREKWE, B.N. SWAMI

Abstract: The research addressed the factors that affect the development of a diversified economy and how the finance sector can become a driving force in economic diversification in Botswana. Primary data were collected through administration of the questionnaire and secondary data were collected from the published documents. The period covered for this study was 2008-2014. The scholars used the Hirschman-Herfindahl Index (HHI) to measure economic diversification by looking at value added by various sectors in the economy and calculated the HHI index across the 7 year period which yielded HHI as 0.11 indicating economic diversification in Botswana.

Key words: Economic diversification & growth, Financial development, HHI

Introduction: Various countries have been managing economies to increase the GDP by diversification. Economic diversification is used not only as way of achieving economic growth but as a way of protecting a country from the vulnerabilities. Botswana (located in Southern Africa) was once a lower income country is now a middle class income country and it is considered to be a developing country. The country's economy is heavily reliant on the export of diamonds followed by the tourism sector and the export of beef. Due to 2008 global financial crisis across the world, the government of Botswana embarked on various strategies that will ensure the economy is well-diversified. The most prominent of these is Economic Diversification Drive 2010 (EDD) which has been considered as a remedy to the then economic slump that Botswana.

Hypothesis: It is assumed that finance sector is vital in the development of a well-diversified economy

Literature Review:

Finance and Economic Growth: It is identified that finance sector influenced economic development [1] and the development of finance sector impacted the pattern of countries' trade balance and changes in income and poverty levels [2]. There is evidence of a relationship between economic and financial development over long periods of time [3]. Financial services such as banking, savings and investment, insurance, debt and equity help citizens to save money, guard against uncertainty, and build credit, while enabling businesses to start up, increase efficiency, and compete in local and international markets[4]. This will lead to a development in the private sector through productivity increase and capital accumulation, macroeconomic stability through investment in long-term, high-return papers, public sector development through investment and key infrastructure and household consumption and human capital accumulation and thereby an overall growth GDP per capita[5], [6].

Finance and Economic Growth in Botswana: Botswana's finance sector can be divided in two segments; the banking sector which is regulated by the Bank of Botswana (the central bank) and the non-bank financial sector regulated by the Non-Bank Financial Institutions Regulatory Authority. Banking sector of Botswana is where most of the commercial activities take place. The non-banking financial sector has all the other essential bodies needed for a thriving finance sector for example the Botswana Stock Exchange and the three statutory finance institutions [7].

Over the past two decades Botswana's economy has experienced growth and this was mainly due to an increase in diamond revenues in the 1980s [8]. The rapid increase in economic growth led to a rapid expansion of the financial system and this resulted in existing commercial banks expanding their business to more than thirty branches or agencies, and the number of bank branches increased and services became widely available [9].

Economic Diversification Drive: Economic diversification drive is vital to countries' long-term economic growth [10]. Diversification "normally refers to exports and specifically to policies aiming to reduce the dependence on a limited number of export commodities that may be subject to price volume fluctuations or secular declines" [11]. Botswana, is heavily reliant on the mining sector mainly diamonds. Recent global financial and economic crisis of 2008-2009 resulted in the fall of diamond sales and hence the influence of mining sector on GDP is trailing behind the finance, business services and government. The economy has become somewhat more diversified, with the non-mining private sector accounting for 69.6% of total value added in 2012, compared with only 48% a decade earlier [8].

Economic diversification drive is used as a means of developing a vibrant and globally competitive private sector. It aims to leverage the government's

purchasing power to stimulate local production and consumption by procuring from locally based manufacturers and service providers [12]. EDD is divided into two types of strategies namely short term and the long term strategy. The strategy has two main areas at its core which are sectorial development & business linkages and export development & promotion. Each has five other areas such as Investment and Finance; Quality Control, Standards and Production; Technology, Development, Transfer and Innovation; Research and Development; and Entrepreneurship Development [13]. Botswana also established some institutions in the drive for economic diversification such as the Botswana Development Corporation (BDC), the Botswana Export Development and Investment Authority, and the International Finance Services Centre (IFSC) [14]. In his 2013 state of the nation address the president of Botswana, H.E Seretse Khama, stated that diversification had been experienced in the manufacturing, finance, transport,

construction, and tourism as well as other services [15].

Botswana is well poised to play a more constructive role in economic diversification and efficient use of national savings. It further goes on to state "with the relatively low level of current risks, the task ahead is largely developmental. Recent moves by banks to serve smaller clients and the non-mining sector, and increasing calls to integrate the regulatory arrangements between the International Financial Services Centre (IFSC) and the rest of the financial system are promising developments" [16]. In the 2014 budget speech Minister of Finance [17], credited the high performance of the non-mining sector for offsetting the dip in performance of the mining sector. Botswana's real GDP was expected to grow by 5.1% due to the impact of finance and business sectors [18]. This could be possible by EDD through the growth of exports and investment opportunities to improve efficiency, technology, innovation and business sophistication [19].

Data Analysis and Findings: Botswana GDP from 2008 to 2014, its growth, per capita GDP in Nominal & Real value.

Table 1: GDP, its growth rate, Nominal and Real GDP per capita (One US \$= 11 Pula)

Year	GDP in million Pula	Annual GDP growth rate	Nominal GDP Per Capita Pula	Real GDP Per Capita Pula
(a)	(b)	(c)	(d)	(e)
2008	74720.90	5.2%	39021.10	35509.20
2009	73462.40	-7.8%	37656.00	32186.90
2010	86867.40	8.6%	43705.90	34298.60
2011	107243.00	6.1%	52962.00	35702.10
2012	125809.60	4.8%	54652.40	36736.50
2013	184025.70	9.3%	59859.80	39420.30
2014	141942.30	4.4%	66289.70	40403.60

(Source: Statistics Botswana GDP Statistics 2015)

Table 1 shows the nominal GDP and its growth rate and nominal and real per capita GDP as observed over the 7 year period from 2008 to 2014. Real per capita is adjusted with inflation. Except in year 2009 and 2014 total GDP was constantly increasing but the rate of increase is not constant. In 2009, there was negative rate in GDP because of worldwide recession.

The Mining Sector, Finance Sector and the Economy: The scholars reviewed the contribution of the mining and finance sector to the gross domestic product during the period under review.

Table 2: Comparative Analysis of Mining and Finance Sector and GDP

Year	Total GDP(Pm)	Mining sector(Pm)	(Mining sector % over (GDP))	Finance & business services (FBS)sector	FBS (%)over GDP
(a)	(b)	(c)	(d)	(e)	(f)
2008	74720.90	18643.50	25.0	9316.70	12.5
2009	73462.40	11209.60	15.3	9694.80	13.2
2010	86867.40	16660.80	19.2	11609.60	13.4
2011	107243.00	26792.20	25.0	13978.80	13.0
2012	125809.60	21997.50	19.5	16644.60	14.8
2013	184025.70	27567.70	21.9	17964.60	14.3
2014	141942.30	32557.10	22.9	19812.90	14.0

Table 2 highlights the sectoral impact on GDP more so by mining and finance sectors. Highest percentage of contribution is by mining sector in 2008 and 2011 being 25% and the lowest registered was 15.3% in 2009 and the impact of mining sector is erratic showing too many fluctuations whereas finance sector (column f) indicated a constant growth increased from 12.5% to that of over 14.8%.

Economic Diversification in Botswana:

Hirschman-Herfindahl Index (HHI) is used to measure diversification by taking the value added by various sectors in the economy across the 7 year period.

$HHI = \sum_{i=1}^n (MS_i)^2$ Where, MS is the market share or in this case it's the percentage of value added by sector

i is the number of sectors and n is the number of period

The HHI average over the seven year period was 0.11; this shows that Botswana's economy is well diversified when using the index.

HHI average =

$$\frac{0.123788 + 0.103567 + 0.112048 + 0.129012 + 0.116479 + 0.120923 + 0.124039}{7}$$

= 0.11

Findings: The real GDP per capita experienced a decline in the years 2009 and 2010 due to the global financial crisis. The case is the same for total GDP, as during the year 2009 there was a decline in total GDP. Total GDP, however, increased from the years 2010 to 2014. It is observed also that in the year 2009 the economy experienced negative growth in the GDP. In the year 2013 the country experienced a highest total GDP and the growth rate was also at its highest during the 7 year period however in 2014 total GDP declined and annual GDP growth experienced a decline too, reaching its lowest rate in 2014. The mining sector continues to contribute a large share to GDP. Total contribution from the mining sector has been fluctuating due to the declining sales of diamonds worldwide. Revenue generated by the finance sector has been on a constant increase from the years 2008 to 2014 however the increase was not high but it's contribution to total GDP has been in a steady rise. Comparing growth in the finance and

business services sector to that of GDP the sector has grown by 213% whilst the economy itself grew by 190%. This shows that the finance sector has been experiencing some growth in difficult times in the economy. Comparing the finance sector to the mining sector in the country the mining sector experienced a growth of 174% which is lower than the 213% of the finance and business services sector.

Looking at economic diversification, Botswana has managed to develop a well-diversified economy as identified HHI which revealed an average of 0.11 indicating well diversified economy.

Conclusion: There was an impact of global recession on the economy of Botswana and the main cause was the country's heavy reliance on minerals as the main source of revenues. When the demand for diamonds and other minerals decreased there was a decline in economic growth. This led to government's efforts to diversify the economy and looked for other means of revenue generation within the economy, i.e. Finance Sector. The HHI analysis index averaging 0.11 confirmed a well-diversified economy. The finance and business services sector in Botswana had experienced exceptional growth over the 7 year period. This shows that the finance sector managed to overcome the challenges that faced the economy during the global financial crisis and hence the scholars conclude in favour of hypothesis which stated that finance sector is vital in the development of a well-diversified economy.

Recommendations: Growth in the finance sector needs to be stimulated. The government should first ensure that the sector is regulated and that there are systems and checks in place to make sure that there is efficient allocation of funds within the economy. In its efforts to diversify the economy the government should ensure that the monetary and fiscal policies should increase growth in the sector, for example if the central bank was to cut the bank rate as part of its monetary policy which leads in increasing lending by banks to businesses, business expansion increases business costs due to the scarcity of utilities such as electricity, water etc. Then the growth will be retarded.

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L. Gaborekwe/B. Fin./Research Scholar/Faculty of Business/University of Botswana/Gaborone/Botswana/
 B.N. Swami/PhD/FCMA/FCA/Professor in Accounting and Finance/Faculty of Business/University of
 Botswana/Gaborone/