The Long Hard Road to Diversification:
Reasons to be Cheerful

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It has been over 20 years since Botswana published its plan to diversify the economy but renewed efforts do not seem to have delivered what was hoped for. Business people and policy makers should not despair, however : virtually everywhere in the world, its the same story : diversification is hard to do.

In 1996, Botswana's national development plan - Vision 2016 - set out seven pillars, the goals for the country to aspire to over the next 20 years. The second pillar - the economic vision, had diversifiction as one of its key goals. By 2016, it was hoped, the country would be enjoying vigorous export-led growth, stimulated by small to medium enterprises (SMEs) and plenty of foreign direct investment.

In 2013, you could be forgiven for thinking that the diversification plan was on track. In his state-of-the-nation address on November 4, President Khama praised the expansion of non-mining sectors such as manufacturing, finance, transport, construction, and tourism and was hopeful : "taken together this is encouraging evidence of diversification." he said.

Last year, the target year for Vision 2016, it was time to take stock. The result has been disappointing, as the Vision 2016 website puts it "the economy has not diversified as planned". It points to, among other things, structural factors of a small market and a small population growing at less than 1%, skills shortages, low levels of information and computer technology and problems with the electricity supply. Twenty years of striving to diversify has not produced the hoped-for results, but Botswana is not alone.

Diversification has been a economic mantra for decades. Development studies students are all taught on day one : economies that don't diversify are heading towards trouble. And in the last few years the D-word has been on everyone's lips with renewed urgency. The crashing prices of oil and primary commodities has had economic planners scurrying to their old text books to mug up on what to do. From Bolivia to Mongolia, Saudi Arabia, Norway and Kazakhstan, the worrying reliance on a single export has, once again, brought about furrowed brows in the various Ministries of Economic Affairs.

Botswana is in the same boat with its own bad news. De Beers cut diamond output in 2009 but the market bounced back, it cut it again last year citing a world glut and reduced demand, but this time was very pessimistic about a recovery. There will not be another bounce. The first budget deficit in Botswana in four years is a chilly reminder that the good times cannot last forever. Something must be done. Countries blessed - or perhaps it should be cursed - with mineral wealth, should, in theory be well placed to diversify by encouraging the development of new sectors, stimulating entrepreneurship with tax breaks, luring foreign investors with incentive programmes and generally kick starting new engines in the economy. But it rarely happens. So, why is it so hard?

Small and medium-sized enterprises (SMEs) represent:

78% of jobs in low-income countries

90% of all new jobs created each year

Dutch disease

Many economists believe that a single source of income actually weakens a country's ability to export and earn a living. This is the mysteriously named "Dutch disease", a term coined by The Economist magazine in 1977 when it tried to figure out why Dutch manufacturing declined after the discovery of a massive offshore gas field. It was later noticed in other countries: oil finds, along with diamonds, gas and any other natural resource can be an economic trap that makes the currency stronger and therefore exports uncompetitively priced. A single-commodity economy can actually find it harder to diversify once it has started to enjoy the fruits of its fortune. The urgency is not just insurance against the day that the oil, diamonds or gas run out, or prices take a permanent slide, its the need to cure a disease. The problem is, ›


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1. Rice fields in Bali. Indonesia has diversified from oil to agriculture
2. Vineyard in Chile
3. Perodua vehicle assembly. Perodua is Malaysia's largest automobile manufacturer closely followed by Proton
4. Jwaneng Mine

every patient needs a different cure.

Xavier Forneris, a trade, competitiveness and emerging markets analyst at the World Bank, has made a study of diversification strategies in single commodity economies and said "Economic diversification is a multi-faceted, highly complex and challenging task. There are lots of failures, few successes, no "silver bullet" or "one-size-fits-all".

Success stories

Successes, where they do occur tend to be partial, and where the many failures in economic diversification have similar features, successful diversifications tend to be strikingly different. Nevertheless, many studies have attempted to see if any recipes can be gleaned from the success stories. Its worth having a look at a few.

Chile is often held up as a success story, because it managed to diversify out of a complete dependence on copper (it has 38% of the world's known reserves and still supplies a third of world consumption) and into fisheries, wine production and business and IT off-shoring. Dubai succeeded in adding real estate development, financial and trade services of the port town of Jebel Ali to its existing oil production, a success that only just about came off. Abu Dhabi managed to develop thriving businesses in tourism and entertainment, trade,


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finance and green energy. Indonesia has gone from oil to agriculture and manufacturing and Malaysia has gone from a dependence on oil and rubber production to being a thriving manufacturer and exporter.

Finally, the poster child for economic diversification in Africa is the tiny island state of Mauritius, written off as a basket case in the early 1960s but now enjoying a boom in manufacturing, tourism and financial services. It was entirely dependent on cane sugar production, which now has all but withered. But all of these countries did not have an easy ride and struggled over many decades, often in the context of political instability.

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Despite the unique characteristics of each country and their economies, Xavier Forneris points to commonalities in the road to successful diversification.

"Its easier to start from your comparative advantages, what you already have than start a totally new industry from scratch." Adding value to existing primary commodities by going downstream is one form of diversification and for Malaysia that meant going from oil, to plastics and petrochemicals. Mauritius turned its cane sugar production to food processing. These are smart moves that Botswana has also tried to use, in the form of diamond beneficiation - the move is only hampered by competition from economies with low labour costs, notably India.

All of the successful moves in diversification have come, in the view of Dr Forneris, from the patient application of a mix of specially adapted tools : a well designed, realistic diversification strategy, firm long term political commitment and - above all, he says "a

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vibrant collaboration between business, government and academia."

Private sector and government involvement

In all the success stories, its the private sector - backed up by government - that is central to diversification, which is where SMEs come in. Entrepreneurship, innovation and the human capital to drive it has always played a bigger role than, say, public sector spending or state-owned industries. Its only recent years that private enterprise in Africa has been looked on as a key component of economic development, whereas in Asia and Latin America it has been much more prominent.

Only as recently as 2011, the think tank, The Africa Progress Panel, pointed to public private partnerships as "among the most promising, and potentially most effective" options for African growth. It said that the private sector was playing an "increasingly important" role. But enthusiasm for the private sector in government circles of African countries doesn't seem to match those in Asia, for example.

Focus on Botswana

In Botswana, relations between government and the private sector have traditionally been cool. It is government, after all, that has provided jobs, not businessmen. But in the vision for the post-diamond economy, entrepreneurs are coming in from the cold in Gaborone, and they're speaking up. And that means calls for more flexible laws on labour and income tax, even if the political will to cut taxation revenue and wages is likely to be hard to find. Botswana's enviable education system is producing highly qualified graduates looking at a bleak employment picture when they complete their studies. Investors looking to set up in Botswana will find no shortage of talent and drive and the entrepreneurial brains of the next generation will be a cornerstone of diversification.

More than anywhere else in the world, it is startups and small businesses that will be the driver of a post-diamond economy in Botswana. And the role of government will be key if they are to succeed.

Writing on the blog of the World Economic Forum for Africa last year James Mwangi and Ashish Thakkar say "The only way we'll create hundreds of thousands of jobs is by placing big bets on small businesses. Small and medium-sized enterprises (SMEs) represent 78% of jobs in low-income countries and more than 90% of all new jobs created each year. These businesses are the true global engines of employment. Increasing rates of entrepreneurship and accelerating the rate at which ventures grow is the only realistic path to creating enough jobs for the next generation." It was government-backed entrepreneurs, often in SMEs, who pioneered the diversification successes of Chile, Mauritius and Malaysia.

And the government of Botswana, to give it its due, is listening. The latest drive to give a pick-me-up to the country's sluggish diversification progress is to dip into some of the its $8.5bn foreign exchange reserves with the Economic Stimulus Programme (ESP) announced in October 2015 and launched a year ago.

Special Economic Zones (SEZs) will, the government says, create a business-friendly climate where investors can get visas and work permits in one place and get easier access to land to build factories and offices. The ESP will also put money into roads, water and power infrastructure. Its exactly what the diversification success stories used to get their new sectors off the ground.

So will Botswana, as the government hopes, start to see a Chilean, Mauritian or Malaysian style burgeoning of its existing strengths in tourism and cattle farming along with tech start ups in the SEZs? Will more foreign investors flock to Gaborone with the cash and brains to keep the country's success story going, after the diamonds have gone? The road to diversification is a long and rocky one, Botswana is doing the right thing and can claim some landmark wins already, but the lesson from the few successful countries is that diversification is hard and it takes time. B