

AFRICA RISK CONSULTING

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The government acknowledges that it has secretly sold fracking licences for over half of the Kgalagadi National Park to United Kingdom (UK)-based Karoo Energy. The government's admission coincides with a global index reflecting the country's deteriorating quality of political governance. Canada-based diamond mining company Lucara discovers the world's second largest diamond at its Karowe mine. The find further reflects the continued profitability of larger stones, amidst a sluggish market for polished, smaller diamonds. The government presents a supplementary budget to manage water and power shortages, and fund additional public services. This reflects the financial costs of the ongoing drought and long standing power generation problems. The World Bank offers a loan facility to assist the government's efforts to mitigate the power and water shortages, and broader economic diversification strategies.

Government admits secret sale of fracking rights in Kgalagadi National Park

The government has sold the rights for shale gas operations in more than half of the **Kgalagadi Trans-Frontier Park**, to **United Kingdom (UK)-based Karoo Energy**. The government reportedly granted the rights in September 2014 without consultation or informing conservationists and senior park officials of the sale.¹ The park is one of **Africa's** largest protected conservation areas. It straddles the border between Botswana and **South Africa** and spans 36,000 square kilometres.² It is famed for animals such as gemsbok, desert antelope, black-maned lions, and pygmy falcons.³

The government had previously acknowledged that foreign companies are fracking for gas in Botswana, but initially declined to confirm issuing fracking licences in the conservation area.⁴ However, the government eventually admitted granting the licences to Karoo Energy's local subsidiary, **Tambouran Botswana (Pty) Ltd**, following media publication of the story.⁵ The mineral, energy and water resources, and environment, wildlife and tourism ministries released a joint statement that the prospective licence is valid from 1 January 2012 to 21 December 2015.⁶ This contradicted information from media investigations that the government had granted the rights in 2014. The ministries also said that the mines ministry is evaluating the company's application for a renewal of the licences.⁷ The government confirmed that the company has undertaken drilling activities, but only outside the park and using core drilling, not hydraulic fracturing (fracking).⁸

¹ Earth Touch, 3 Dec 2015.

² The Guardian, 2 Dec 2015.

³ CBC, 2 Dec 2015.

⁴ CBC, 4 Dec 2015.

⁵ The Southern Times, 11 Dec 2015.

⁶ The Southern Times, 11 Dec 2015.

⁷ The Southern Times, 11 Dec 2015.

⁸ The Southern Times, 11 Dec 2015.

Fracking is a method of extracting natural and petroleum gas through drilling and injecting water mixed with chemicals to break sedimentary rocks, or shales containing the gas.⁹ Although park officials had stated that the company had not commenced drilling operations, media investigations near a popular camping site in the park have revealed evidence of oil drilling.¹⁰ Scientist **Gus Mills**, who has worked in the park for 18 years, indicated that fracking will have an adverse impact on wildlife and the environment in general.¹¹ Drilling infrastructure and other waste products will disrupt the park's ecosystem, and cause both land and water table pollution, mostly through the injection of fracking chemicals deep underground.¹² Drilling operations will also affect the country's tourism operations, as the park become less attractive to visitors.¹³ The **World Travel and Tourism Council** indicates that tourism is the country's second largest revenue earner after diamonds, employing 32,000 people.¹⁴

The tourism managers for the South African and Botswana sides of the park, **Ben van Eerden** and **Leabaneng Bontshetse** respectively, both expressed shock at the news that Botswana's department of minerals had issued licences.¹⁵

*"The government allowed fracking companies to operate in the Kgalagadi Reserve as far back as 2012, and its recent admission is in response to **The Guardian's** exposé. Botswana is lauded internationally as a leading conservation promoter on the continent, with President **Ian Khama** (2008-present) winning the coveted **International Union for the Conservation of Nature** award in 2012."¹⁶*

This development comes as Botswana is facing a gradual deterioration of the rule of law and its famed democratic standards. The **World Justice Project's Rule of Law Index 2015** revealed that the government has become less accountable, respect for human rights has decreased, and the judicial system is less independent.¹⁷ It showed that Botswana is the only country in **Southern Africa** to show a downward trend on constraints to government powers during the 2015 review period.¹⁸ It dropped from first to third place in 2015 in the region and from 20 to 32 in the world on accountability and balance of power between the main arms of government.¹⁹ Although it remained first in the region on the strength and fairness of its legal and administrative regulatory authority, it dropped in global rankings from 17 during the 2012-2013 period to 22 during 2015.²⁰ The World Justice Project is an independent organisation that advances the rule of law worldwide, through research, scholarship, engagement and its Rule of Law Index.²¹ The quality of political governance has deteriorated under Khama, and the secret sale of the mining rights is symptomatic of the lack of accountability and transparency under his rule.

*"[Khama] is reportedly heavily invested in **Wilderness Safaris**, arguably the largest tourism company in Africa. However, the secrecy surrounding fracking in the national park*

⁹ American Petroleum Institute website.

¹⁰ The Guardian journalists conducted the investigation prior to publishing this report.

¹¹ CBC, 4 Dec 2015.

¹² CBC, 4 Dec 2015.

¹³ The Guardian, 2 Dec 2015.

¹⁴ The Guardian, 2 Dec 2015.

¹⁵ Earth Touch, 3 Dec 2015.

¹⁶ Source, analyst

¹⁷ Sunday Standard, 7 Dec 2015.

¹⁸ Sunday Standard, 7 Dec 2015.

¹⁹ Sunday Standard, 7 Dec 2015.

²⁰ Sunday Standard, 7 Dec 2015.

²¹ World Justice Project website

*reflects the government's double standards as far as conservation is concerned, and the level of corruption under Khama's government."*²²

Lucara unearths world's second largest diamond

Canada-based **Lucara Diamond Corp** unearthed a 1,111-gem quality diamond at its **Karowe** mine in Botswana on 17 November. It becomes the world's second largest diamond, second in size only to the 3,106-carat **Cullinan** diamond found in South Africa in 1905.²³ It was subsequently set into the **British** royal jewels.²⁴ Lucara CEO **William Lamb** said that the company has since received multiple offers for the diamond, but will delay its sale in order to determine its actual value.²⁵ The company will have to scan and render the diamond in 3D to determine how best to use it and how many pieces to cut it into.²⁶ Its colour, clarity, cutting and polishing will also determine its value.²⁷ Analysts predict that the diamond is likely to fetch a very high price because of its historical significance and prestige.²⁸

*"Based on Lucara's previous sales by size, the diamond is worth approximately \$60m. However, this diamond's value will exceed its physical qualities, due to it being the largest diamond in the world that is not part of a royal or personal collection. Its eventual owner will likely be a very high net worth collector or institution. However, it remains unclear what percentage of the diamond's sale will directly transfer to the government, due to the entrenched culture of secrecy in the diamond industry."*²⁹

The diamond is classified as **Type IIa**, meaning it is an excellent quality stone nearly devoid of impurities.³⁰ The company's shares rose by 30% on the **Toronto Stock Exchange** by 19 November as news of the find spread.³¹ Lucara also unearthed 813-carat and 374-carat diamonds in the same week.³² In July, it sold 341,9-carat and 269,7-carat diamonds.³³ Lucara's Karowe mine began production in 2012 and has already gained a reputation for producing high quality diamonds.³⁴ Since the diamond discovery, Lucara plans to invest between \$15-18m in additional large diamond recovery process at its Karowe mine.³⁵ It had previously installed several XRT x-ray machines at its processing plant at Karowe, which will improve the odds of discovering more large diamonds.³⁶ The company forecasts that it will treat between 2,2 million and 2.4 million tonnes of ore in 2016, producing approximately 350,000 carats of diamonds.³⁷ It competes with **Gem Diamonds' Letseng** mine in **Lesotho**.³⁸ Gem Diamonds held the previous record for this century's largest recovered diamond, the 603-carat **Lesotho Promise** diamond in 2006 that sold for \$12.4m.³⁹

²² Source, analyst

²³ Bloomberg, 19 Nov 2015.

²⁴ Bloomberg, 19 Nov 2015.

²⁵ Mail and Guardian, 26 Nov 2015.

²⁶ Forbes, 20 Nov 2015.

²⁷ Bloomberg, 19 Nov 2015.

²⁸ Wall Street Journal, 19 Nov 2015.

²⁹ Source, analyst

³⁰ Wall Street Journal, 19 Nov 2015.

³¹ Wall Street Journal, 19 Nov 2015.

³² BBC, 19 Nov 2015.

³³ Forbes, 20 Nov 2015.

³⁴ Financial Post, 18 Nov 2015.

³⁵ Creamer Media, 3 Dec 2015.

³⁶ Northern Miner, 2 Dec 2015.

³⁷ Creamer media, 3 Dec 2015.

³⁸ Wall Street Journal, 19 Nov 2015.

³⁹ Wall Street Journal, 19 Nov 2015.

The diamond discoveries come against a background of a relatively sluggish global market for diamonds due to low demand, especially in **China**, and the strength of the **United States (US)** dollar, which makes diamonds more expensive for most of the world.⁴⁰ As a result, banks are unwilling to lend to diamond cutters and polishers.⁴¹ However, exceptional diamonds continue to fetch high prices.⁴² **Hong Kong** business tycoon **Joseph Lau** bought a 12.03-carat diamond for \$48.5m at a **Sotheby's** auction in November.⁴³ Despite the global slump that has affected government revenue, **McKinsey and Co** predicts that diamond production will peak in 2017, with a possible decline thereafter.⁴⁴

Supplementary budget to address power and water shortages...

The finance ministry has requested an additional \$123.28m from parliament for the 2015-16 financial year to manage water and power shortages. It presented the supplementary budget to parliament on 8 December.⁴⁵ It plans to allocate \$74m to the country's national power utility for electricity imports and the purchase of coal for local power generation, and \$17m for the **Water Utilities Corp** to upgrade water supply infrastructure to the capital, **Gaborone**.⁴⁶

The supplementary budget comes amid a reduction in the country's economic growth rate, with the 2015 growth forecast reduced by 2.6% in September due to a sharp drop in in global diamond prices.⁴⁷ Diamonds account for approximately 75% of Botswana's foreign currency earnings, and 30% of its GDP. Nevertheless, international sovereign credit rating agency, **Moody's Investors Service** has reaffirmed Botswana's 2015 **A2** sovereign credit rating both for domestic and foreign bonds, and affirmed a stable outlook for 2016.⁴⁸ The rating is based on an assessment of the government's relatively strong balance sheet, strong net creditor position, and low public debt against potential challenges associated with middle-income status and a small economy.⁴⁹ The agency also praised the country's strong financial institutional framework, and expects the government to implement fiscal and monetary policies that allow the economy to adjust to lower diamond prices and other external shocks.⁵⁰ However, it cautioned that the economy's heavy reliance on the diamond sector and relatively slow pace of economic diversification remain key weaknesses that may affect its rating in the long term.

... as World Bank avails financial and technical assistance facility

The **World Bank** has pledged a \$271m loan facility to finance development projects from 2016-2018, especially in the water and renewable energy sectors.⁵¹ The facility is part of the World Bank's **Country Partnership Framework (CPF)**, which proposed a strong programme of technical and financial support for the country.⁵² More than half of the facility will fund water access and sanitation, since there are sharp disparities in water access across the country.⁵³ For instance, several areas countrywide have only 20-30% access to piped water while Gaborone

⁴⁰ Northern Miner, 2 Dec 2015.

⁴¹ Northern Miner, 2 Dec 2015.

⁴² Bloomberg, 19 Nov 2015.

⁴³ Bloomberg, 19 Nov 2015.

⁴⁴ Wall Street Journal, 12 Nov 2015.

⁴⁵ Creamer Media, 10 Dec 2015.

⁴⁶ Eyewitness News, 9 Dec 2015.

⁴⁷ Reuters, 10 Dec 2015.

⁴⁸ Daily News, 14 Oct 2015

⁴⁹ Daily News, 14 Oct 2015

⁵⁰ Daily News, 14 Oct 2015

⁵¹ Mmegi, 4 Dec 2015.

⁵² Mmegi 1 Dec 2015

⁵³ Mmegi, 4 Dec 2015

has 80% access.⁵⁴ Only 42% of the rural population has access to adequate sanitation.⁵⁵ The World Bank also noted that water and sanitation are crucial since Botswana's growth opportunities will be unsustainable in the absence of reliable water sources.⁵⁶ The World Bank will also assist Botswana's economic diversification programmes, mainly through developing an export oriented, private sector driven economy that will increase broad-based employment.⁵⁷ It also plans to explore opportunities for supporting small and medium enterprises, providing capital and capacity building of banks, and promoting financial inclusion.⁵⁸

The country is going through a dry spell that has diminished water levels, especially in the **Gaborone Dam**, causing water shortages in the capital city. Those who can afford to, have resorted to buying water for storage in large tanks, while water rationing to the industrial sector has led to cutbacks in production.⁵⁹ The **United Nations (UN)** recently expressed concerns with the country's water shortages. Following a fact finding mission to Botswana in November 2015, the **UN Rapporteur for the Human Right to Safe Drinking Water and Sanitation, Leo Heller**, indicated that the government ought to partner with regional bodies and international organisations to develop lasting solutions to the water crisis.⁶⁰

Implications

The government's sale of fracking licences to a UK company in secret reflects the erosion of accountability in the country's political system. Hydraulic fracking operations are likely to result in considerable environmental pollution, which will interfere with tourism and local rural livelihoods. Recent global indicators confirm the deteriorating quality of governance under Khama's rule. Future global governance indicators are likely to record similar results, which will potentially influence investor choices in the long term.

The recent discovery of the world's second largest diamond at Lucara's Karowe mine reinforces the growing profitability of the large diamond market. However, profitability depends on frequent discoveries, with the rest of the polished stones market remaining weak in the long term, despite forecast resurgence in 2016. Botswana still needs to diversify from diamond revenue and mining in general.

The supplementary budget request highlights the economic consequences of the ongoing drought in Botswana. The United Nations and World Bank have stepped in to assist the government to manage the water and power shortages. This news will mitigate investor fears of further deterioration in the operating environment due to current industrial cutbacks.

⁵⁴ Mmegi, 4 Dec 2015.

⁵⁵ Mmegi, 4 Dec 2015.

⁵⁶ Mmegi, 4 Dec 2015.

⁵⁷ Mmegi, 1 Dec 2015.

⁵⁸ Mmegi, 1 Dec 2015.

⁵⁹ Mmegi, 19 Nov 2015.

⁶⁰ Mmegi, 19 Nov 2015.

About Africa Risk Consulting:

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