



### Botswana's Enabling Environment for Economic Diversification: Plugging the Holes

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#### 1. Introduction

It is widely recognized that economies endowed with natural resources and highly dependent on one or two primary commodities for exports are susceptible to exogenous shocks that can lead to fluctuations in export earnings. The unpredictable nature of export earnings from primary products, especially when a narrow range of such products is exported, makes it difficult for countries to plan and allocate their resources efficiently, thereby hindering sustainable economic growth and development. This is particularly evident in countries where backward and forward linkages are limited or non-existent within and between resource-based sectors and the rest of the economy.

The uncertainty over the stability of future output growth that often characterizes resource-abundant economies can be countered to some extent by economic diversification, which calls for the broadening of the range of products and services produced for export. This may include broadening the range of primary products exported, so as to reduce dependence on a narrow range of primary export products and avoid the associated vulnerabilities. Diversification may include increasing the degree of processing of

primary products prior to export, which can lead to additional local value added and reduced dependence on primary product markets. More generally, diversification is usually understood to include the production of a range of industrial and service exports. Depending on the nature of the products, this can be a skilled labour-intensive and technology-driven process that transfers growth-enhancing spillover benefits to the rest of the economy and promotes sustainable economic growth. It is generally accepted that the private sector, defined as all economic activities not produced by the public sector, is the most powerful tool for achieving economic diversification. It induces a spiral effect on foreign and domestic investment, growth, employment, productivity and poverty alleviation.

Stimulating economic diversification through broadening the range of export products requires new investment in a range of activities, which is itself dependent upon the nature of the enabling environment for both domestic and foreign investment. Botswana's enabling environment for investment was assessed in a Report prepared by BIDPA and World Bank entitled "Diversifying Botswana's Exports:

An Overview” (2005). This Policy Brief presents the main findings of that assessment. It focuses on the achievements, challenges and the way forward for Botswana in providing a business environment conducive for economic diversification. To this end, the Policy Brief also provides a critical overview of what has been achieved so far, and identifies what remains to be done.

## **2. What Constitutes An Enabling Business Environment?**

Foreign and domestic private enterprises develop best in business friendly climates that are characterized by, among others, a stable macroeconomic framework, efficient legal and regulatory frameworks, and good governance. These elements impact of the performance of firms through<sup>1</sup> :

- (1) Costs (through regulatory burden and red tape, taxes, levels of corruption, infrastructure services, labour market regulation and finance);
- (2) Risks (through policy predictability, property rights and contract enforcement); and
- (3) Barriers to competition (through regulations controlling startup and bankruptcy, competition law, and entry to finance and infrastructure markets).

Government plays an important facilitative role in establishing and maintaining these elements in a manner that promotes private sector investment.

Trading partners, in particular developing countries, bear witness to fierce competition amongst each other to provide ideal business conditions that attract foreign direct investment (FDI). FDI brings in much needed capital, technical know-how, and international business best practices that facilitate the process of economic growth. Further, at domestic level, a favourable business climate grants local entrepreneurs opportunities to be economically active, especially the poor who need job creation for poverty alleviation.

## **3. What Are Botswana’s Achievements?**

This section reviews Botswana’s efforts to promote economic diversification by providing for an environment conducive to foreign and domestic investment and entrepreneurship. It considers both key general achievements that apply across the board, and specific issues for foreign direct investment, local business enterprises, and export-oriented sectors.

### **Overview of General Business Climate**

The overall general legislative, legal and institutional frameworks in Botswana are fairly conducive for attracting private sector investment for economic diversification. Among other key pro-investment conditions, Botswana is a stable, open democratic economy, known for prudent fiscal and monetary policy management. Through the current National Development Plan (NDP 9), whose theme is “Towards Realization of Vision 2016: Sustainable and Diversified Development through Competitiveness in Global Markets”,

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1. <http://www.worldbank.org/Themes/Business Environment>

Botswana recognizes the need for economic and institutional frameworks that promote globalization and investment opportunities.

Botswana has a generally competitive tax regime. Tax incentives include a low general company tax rate of 25%, a maximum 25% personal income tax rate, a preferential profits tax rate of 15% for manufacturing and offshore financial International Financial Service Centre (IFSC) entities, and tax allowances including provisions for tax holidays, tax credits, exemptions and special deductions for employment or training.

Botswana's integration with regional and global partners through multilateral, regional and bilateral agreements boosts confidence in its political and economic stability, further enhancing its competitiveness for private sector investment.

### **Conditions for Foreign Direct Investment**

Botswana has traditionally maintained a very liberal and open foreign direct investment regime. FDI is welcomed across the board, with the exception of a few industry sectors that are reserved for citizens. Foreign exchange controls were abolished in 1999. The country is generally considered a favourable potential destination for investment by both global and regional investors. According to the World Bank Reports on "Doing Business" which have been issued from 2004 to 2006, Botswana scores relatively well in the region in terms of creating an enabling environment for business. In the 2006 report, Botswana is rated fourth among 40 African countries, after Mauritius, South Africa and Namibia. Relative to other

countries, Botswana does well on measures related to flexibility of employment legislation, getting credit, enforcing contracts and closing a business, although it does less well on starting a new business, dealing with licenses, trading across borders, protecting investors, registering property and paying taxes.

### **Conditions for Local Business Enterprises**

Botswana has adopted several policies and programmes over the years that promote citizen empowerment and foster entrepreneurship and employment creation. These include the Financial Assistance Policy (FAP) a capital and labour grant scheme which was established in 1982 and terminated in 2000. It was later replaced by the Citizen Entrepreneurial Development Agency (CEDA) in 2001. CEDA supports the development of citizen run businesses through interest subsidized loan funding, training, mentoring and benchmarking.

From 1988 to 1996 the Selebi-Phikwe Regional Development Project was set up to support business development in Selebi-Phikwe through preferential tax breaks and tax rates. Although it has since been phased out, elements of it were merged with the general industrial promotion scheme of the Ministry of Trade and Industry. Still ongoing are the Local Preference Scheme which was established in 1976 to provide local producers preferential supply of goods for government contracts and the Reservation Policy which was introduced in 1982 that reserves certain economic activities exclusively for citizen owned businesses. The scope of the Reservation Policy has recently been extended. There are also preferences for locally-owned companies in public procurement.

## Conditions for Export-Oriented Sectors

Botswana has a number of policies, regulations and institutions that specifically target export-oriented businesses. These include the Customs and Excise Duty Act and the Value Added Tax (VAT), which provide for exemption from payment of certain customs and excise duties, as well as VAT, on raw material imported by export manufacturing firms. However, there are no specific tax benefits offered to companies that export, in line with WTO rules. There are relatively few restrictions on exports, which apply only to the export of rough diamonds and the prohibition of livestock exports.

There are several institutional bodies that support export companies, including the Ministry of Trade and Industry (MTI), Botswana Export Development and Investment Authority (BEDIA), Botswana Confederation of Commerce, Industry and Manpower (BOCCIM), Exporters Association of Botswana (EAOB), Enterprise Botswana, Botswana Development Corporation (BDC), Botswana Bureau of Standards (BOBS) and Venture Capital Botswana. The Botswana Export Credit Insurance and Guarantee Company (BECI) provide short term credit insurance. Government/private sector consultative forums include the High Level Consultative Council (HLCC), National Employment Manpower and Incomes Council (NEMIC), the National Business Council, and Smart Partnership.

### 4. What remains to be done?

The previous section provided an overview of elements of an enabling business environment, where Botswana appears to be relatively successful. Judging by these only, we could conclude that the country has a very conducive

environment for private sector investment with potential for successful economic diversification. However, despite Botswana's overall performance in providing a business friendly environment for export-led growth and economic diversification, there remain some holes that need be plugged. Some of the specific challenges that hinder private sector investment in Botswana are detailed below.

### Outstanding laws and revisions

A pro-active approach in the revision and introduction of laws in a timely fashion that keeps pace with current events needs to be spearheaded. A number of laws and regulations remain outstanding, including the new Competition Policy Act, revisions to the Development Act to simplify industrial licensing processes that delay the start-up of businesses, the drawing up of an Investment Code that would genuinely support smaller FDI, and revisions to the Reservation Policy and Local Procurement Program to remove anti-export bias restrictions.

### Supply of timely data and information

For investors and business owners to make informed decisions it is important to have reliable up-to-date data and information. Botswana is lacking in this front. Delays are experienced in the collection of data and the quality and calculations are questionable. To improve the availability of economic data, the following recommendations were made in the World Bank/BIDPA Report: quarterly macroeconomic data should be made available; procedures and capacity for data collection should be reviewed; Customs and CSO software should be integrated; the role of providing data should be contracted out; and provision

of estimates of productivity and producer price index should be made to facilitate the calculations of valuable economic data.

### **Monitoring and implementation**

In 2003, Foreign Investment Advisory Services (FIAS), an agency of the World Bank, reviewed the constraints to FDI in Botswana, and made a number of recommendations. By the time the World Bank/BIDPA report was published, little had been done to implement these recommendations, and as of mid-2006, the situation remains unchanged. Government therefore needs to monitor the implementation of the FIAS report more effectively. There is also a lack of data to undertake financial cost-benefit analysis to determine whether tax incentives for inward investors engaged in export business yield a positive net financial return for Botswana. To this it is recommended that there should be an appraisal of broad and specific subsidies, government support programmes and tax incentives. MTI's political risk reinsurance services are viewed as inadequate and insufficient by stakeholders. There is need to conduct a performance audit, including an assessment of need.

### **Provision of utility services and serviced land**

Government continues to own and control key utilities. In principle, Government has committed to privatization, although none have yet taken place, and concerns remain about the level of efficiency of utilities, the prices charged, monopoly powers and lack of competition. Also of great concern is the provision of serviced industrial land, which is characterised by delays, inefficiency and high prices, with particular difficulties facing foreign

investors. The World Bank/BIDPA Report recommends that government encourage private developers to provide serviced land and share infrastructural costs with private users. Further, the difficulties of foreign investors being able to acquire land also need to be addressed.

### **Labour-related concerns**

There are concerns about the restrictive nature of rules governing the employment of non-citizens. Specifically, obtaining work and residence permits are consistently identified as among the most difficult investment procedure in Botswana. Recent increases in the costs of obtaining work permits and visa are viewed with concern in the hiring of foreign personnel, although the non-availability of permits, political interference, lack of transparency and inconsistent policy implementation by government officials, and corruption in relevant departments are far more serious problems. An overly restrictive immigration policy is one of the most serious constraints to economic diversification in Botswana, and demonstrates a lack of appreciation of the factors governing the success or otherwise of a small economy in a globalising world. Solutions to this problem involve government assessing the costs of obtaining a work permit and visa, formulating a system for work and immigration permits that is transparent and efficient, and liberalising the system to allow firms to meet all of their labour needs without undue restraint.

Currently manpower planning does not involve coherent projections of occupational outputs from all key post-secondary educational and training institutions, and there is no national register of available skills and human resources. This needs to be encompassed in a national human resource development strategy

that focuses on occupational requirements of key growth sectors. Further a labour market information system needs to be developed which includes a reform plan for vocational education and training sector.

### **Export-oriented sector concerns**

To promote business activity in all sectors of the economy it is recommended that the preferential tax rate of 15% applied to the manufacturing sector and to offshore financial services should be further extended to other activities.

The government's beef export monopoly along with bans on beef imports and live cattle exports has caused huge distortions in the cattle industry, which was previously one of Botswana's main export sectors. For the industry to exploit its full potential a wide range of reforms are needed, including trade liberalisation and the restructuring and privatisation of BMC. The emergent ostrich industry has struggled to get established for a number of reasons, and it was recommended that the export levy that discourages value addition should be eliminated.

Considerable changes are necessary to give the tourism sector a boost, including the establishment of local tourism associations affiliated to the Hotel and Tourism Association of Botswana (HATAB). A formal partnership agreement needs to be created between government and the private sector. Further, it is viewed important that the Department of Wildlife and National Parks be an active and key partner in the formulation and implementation of the national tourism strategy. Research is also needed to evaluate the costs and benefits of allowing customary land grants to exceed the

15 year period that is currently the maximum permitted for operators in key tourism areas.

A number of recommendations were made with regard to financial service exports. Specifically, Government should make further efforts to streamline the process of obtaining IFSC tax and regulatory approval and reduce the number of bodies involved; IFSC incentives should be broadened to include all export services; efforts to negotiate double taxation agreements should be increased; and the establishment of a new regulatory structure for the non-bank financial system should be completed.

The textile and apparel sector is threatened by a number of domestic and international policy changes, including the phase-out of the Multi-Fibre Agreement (MFA), the possible end of special access to the US market through the Africa Growth and Opportunity Act (AGOA) and the ending of FAP subsidies. The Report recommended that BEDIA hold consultation meetings with manufactures to address their concerns. The textile and apparel industry is also threatened by low productivity levels associated with, among others, high rates of HIV/AIDS prevalence in the country. Further in-company interventions need to be developed as part of an overall national AIDS strategy to deal with HIV/AIDS issues. To deal with productivity issues, it was recommended that BEDIA develop a comprehensive response that addresses this sector's training needs. The industry also does not have an industrial association to lobby and negotiate specific needs. It is suggested that BEDIA can use its premises to facilitate the establishment of such an association.

With regard to import tariffs and exemption schemes for exporters, Botswana needs to

propose to SACU to allow anti-dumping tariffs to be eligible for duty exemptions and rebate schemes. There also needs to be a review of whether broadening the definition of inputs that are exempted from customs and VAT will significantly reduce costs for exporters.

## **5. Conclusions**

This Policy Brief summarises the main findings of the Report entitled “Diversifying Botswana’s Exports: An Overview” (World Bank, 2005), with particular focus on Botswana’s enabling

environment for economic diversification through exports. In view of the above, and at the risk of generalising policy recommendations, it appears that broad policy measures are more needed to address issues of non-citizen labour regulation, infrastructure service provisions, access to land, monitoring and implementation of government reform programs, updating and introduction of new laws, and availability of timely data and information. Administrative procedures that delay the start-up of businesses also remain a constraint issue. The overall approach recommended in the report is the adoption of international best-practice principles in addressing these issues.



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