

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

INVESTMENT POLICY REVIEW

BOTSWANA



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Investment Policy Review

Botswana



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PREFACE

The UNCTAD Investment Policy Reviews are intended to help countries improve their investment policies and to familiarize governments and the international private sector with an individual country's investment environment. The reviews are considered at the UNCTAD Commission on Investment, Technology and Related Financial Issues.

The Investment Policy Review for Botswana was initiated at the request of the Government. The UNCTAD fact-finding mission, undertaken in June 2001, received the full cooperation of senior officials of the Ministry of Trade and Industry, the designated cooperating agency, as well as relevant government ministries and statutory authorities. The mission also had the benefit of the views of representatives of the private sector, foreign and domestic, as well as those of the resident international community, particularly bilateral donors and development agencies.

The Review was considered by the UNCTAD Commission on Investment, Technology and Related Financial Matters on 11 June 2002, and was presented to a national workshop on 9 July 2002. The assessment and major recommendations of the Review have been endorsed by the Government, and a follow-up programme is under way with financial support from the United Nations Development Programme.

This report was prepared by Rory Allan, Zbigniew Zimny, Lena Chia, Diana Barrowclough and Erich Supper, under the direction of Khalil Hamdani. Inputs were also provided by Joseph Mathews and Charles Harvey. The survey of foreign affiliates in Botswana was carried out by Thapelo Matsheka. Chiraz Baly and Lang Dinh provided research assistance, and Elisabeth Anodeau-Mareschal and Deborah Wolde-Berhan provided production support.

The project was financed by the United Nations Development Programme and by the UNCTAD/UNDP Global Programme on Globalization, Liberalization and Sustainable Human Development.

It is hoped that the analysis and recommendations of this review will promote constructive dialogue among the key stakeholders within the country, contribute to an improvement of policies and promote wider awareness of the investment environment in Botswana.

Geneva, November 2002

CONTENTS

PREFACE	III
ABBREVIATIONS	IX
BOTSWANA: KEY ECONOMIC AND SOCIAL INDICATORS	X
INTRODUCTION	I
I. FOREIGN DIRECT INVESTMENT: TRENDS AND IMPACT	3
A. <i>ECONOMIC BACKDROP</i>	3
B. <i>FDI TRENDS</i>	4
1. FDI size and growth	4
2. Distribution by sector and industry	9
3. Types of FDI	11
4. Countries of origin	12
5. Relative importance of FDI in the economy	14
C. <i>IMPACT OF FDI</i>	15
1. Capital and investment	15
2. Technology and skills	16
3. Employment and linkages	18
4. Diversification of output and exports	20
D. <i>ASSESSMENT</i>	22
II. THE INVESTMENT FRAMEWORK	25
A. <i>SPECIFIC FDI MEASURES</i>	25
1. Entry and establishment	25
2. Treatment and protection of FDI	27
B. <i>GENERAL INVESTMENT MEASURES AND CONDITIONS</i>	29
1. Foreign exchange control	30
2. Taxation	30
3. Employment	32
4. Employment of non-citizens	33
5. Land	37
6. Competition policy	38
7. Rule of law and respect for property rights	38
8. Intellectual property protection	38
9. Corporate governance and accounting standards	39
10. Licensing and administration of regulations	39
C. <i>SECTORAL INVESTMENT INCENTIVES AND RELATED INITIATIVES</i>	40
1. Introduction	40
2. Financial Assistance Policy	41
3. Tax agreements and development approval orders	42
4. Sectoral initiatives	43
D. <i>THE PROPOSED FOREIGN INVESTMENT CODE AND RELATED ISSUES</i>	48
1. Review of the code	48
2. Recommendations on the foreign investment code	51
E. <i>ASSESSMENT AND RECOMMENDATIONS</i>	52
III. STRATEGIC PERSPECTIVES	55
A. <i>INVESTMENT POTENTIAL</i>	55
B. <i>ELEMENTS OF AN FDI STRATEGY</i>	57
1. Market access	57
2. Increasing competitiveness	61
3. Local private sector development	63
4. Human capital development	66
5. Investment promotion	69
C. <i>SUMMARY OF FINDINGS AND POLICY RECOMMENDATIONS</i>	73
IV. CONCLUSIONS AND RECOMMENDATIONS	75
REFERENCES	77

Figures

I.1.	FDI inflows into Botswana, 1975-2000	5
I.2.	Botswana: Inward FDI stock, 1975-2000	9
I.3.	Stock of FDI in Botswana by industry, 1999	10
I.4.	Stock of FDI by country of origin, 1999.....	13
I.5.	Botswana: composition of exports by major categories, 1990-2000	21

Tables

I.1.	FDI in Botswana compared with SADC and LDCs, 1975-2000,	7
I.2.	Botswana's FDI flows and stocks compared to selected countries, 1986-2000	8
I.3.	Botswana: New FDI projects in manufacturing, 2000-2001	12
I.4.	Major foreign affiliates in Botswana	13
I.5.	The estimated importance of foreign affiliates in manufacturing industries, 2000.....	14
I.6.	Savings and investment ratios, Botswana and Africa, 1975-2000	16
II.1.	Guide to assessment of operating conditions	30
II.2.	Public sector wages	33
II.3.	Labour force localization rates	35
II.4.	Investment incentives available for FDI	40
II.5.	Financial Assistance Policy grants	42
II.6.	Foreign Investment Code: Minimum amounts of investment.....	48
II.7.	Summary of recommendations	53
III.1.	Comparative cost of infrastructure services, late 1990s.....	61
III.2.	Private local enterprises in Botswana, 1998	63
III.3.	Comparative education profile of Botswana	68
III.4.	Botswana's readiness to promote FDI.....	71

Boxes

I.1.	Refinancing the losses of BCL Ltd.	5
I.2.	Financing FDI locally	6
I.3.	Motor Company of Botswana	11
I.4.	The impact of FDI in export-oriented manufacturing in Botswana.....	17
I.5.	Transfer of skills in banking	18
I.6.	Encouraging entrepreneurship	19
II.1.	The business licensing system and the entry of FDI	26
II.2.	Modernization of the mining sector regime	44
II.3.	International Financial Services Centre	45
III.1.	Business costs of poor governance	57
III.2.	Botswana's trade agreements	58
III.3.	Linkages: International experience	64
III.4.	Conditions for a promotion-led FDI strategy	70

Annex: Suvey of forelgn affiliates in Botswana.....79

Annex table

Annex figures

Annex box

ABBREVIATIONS

AAB	Auto Ancillaries Botswana
ACP	Asian, Caribbean and Pacific countries
ACHAP	African Comprehensive HIV/AIDS Partnership
AGOA	African Growth and Opportunities Act
BEDIA	Botswana Export Development and Investment Authority
BIDPA	Botswana Institute of Development Policy Analysis
BIT	bilateral investment treaty
CEDA	Citizen Entrepreneurial Development Agency
CIS	Commonwealth of Independent States
DTT	double taxation treaty
EPZ	export processing zone
EU	European Union
FAP	Financial Assistance Policy
FDI	foreign direct investment
GDP	gross domestic product
GDS	gross domestic savings
GFCF	gross fixed capital formation
GNP	gross national product
HATAB	Hotel and Tourism Association of Botswana
IFSC	International Financial Services Centre
ILO	International Labour Office
LDC	Least developed country
MIGA	Multilateral Investment Guarantee Agency
MCB	Motor Company of Botswana
NDP	National Development Plan
NILA	National Industrial Licensing Authority
OECD	Organization for Economic Co-operation and Development
PDSF	Public Debt Service Fund
REP	regional economic partnerships
SACU	Southern African Customs Union
SADC	Southern Africa Development Community
SME	small and medium-sized enterprises
SWOT	strengths, weaknesses, opportunities and threats
TNC	transnational corporation
WTO	World Trade Organization

BOTSWANA

Botswana became an independent democratic republic in 1966 after 80 years of rule as a British protectorate. The constitution adopted at independence vests legislative power in a parliament comprising the National Assembly (with 40 elected members), the President, a speaker, the attorney-general and four members nominated by the Government. The country is democratically ruled and boasts a stable political environment. The Botswana Democratic Party has been a major political force. Botswana is the second largest producer of diamonds (by volume) in the world after Australia, and the largest in terms of output value. Until the 1990s, it was the fastest growing economy in the world.



Key economic and social indicators

INDICATOR	1980	1985	1990	1995	2000
Population (million)	0.91	1.08	1.28	1.47	1.60
GDP (\$ billion)	1.13	1.19	3.77	4.90	5.30
GDP per capita (\$)	1 247	1 101	2 945	3 331	3 312
Annual GDP growth (per cent)	11.50	10.10	10.20	5.10	9.10
GDP by sector (per cent)					
Agriculture	12.00	10.98	4.58	3.99	3.00
Mining	32.00	32.60	32.60	32.60	36.00
Industry, of which:	12.09	17.58	23.77	13.01	9.00
Manufacturing:	5.26	5.62	4.90	4.74	4.97
Services	43.91	38.84	39.05	50.40	52.00
Exports of goods and services (as % of GDP)	49.74	61.97	55.42	49.70	56.00
Imports of goods and services (as % of GDP)	52.12	40.07	50.10	36.04	43.50
Inflation	13.67	8.10	11.39	10.51	8.70
Gross domestic savings/GDP (%)	34.43	42.83	37.05	40.56	40.50
Gross domestic investment/GDP (%)	36.80	20.94	31.73	26.90	28.10
FDI inflows (\$ million)	111.55	53.60	95.90	70.41	30.00
FDI inflows/ GDP (%)	9.87	4.50	2.54	1.44	0.83
Import coverage ratio of reserves (months of import of goods and services)	4.00	..	16.00	22.00	26.00
Human development index	0.56	0.62	0.65	0.62	0.577 ^a
Adult literacy rate (percentage of people aged 15 years and over)	57.60	63.00	0.65	72.70	76.4 ^a

a) 1999

Source: UNCTAD, FDI/TNC database; World Bank (various years); World Bank (2001); Economist Intelligence Unit, (2002), and UNDP (various years).

INTRODUCTION

Botswana emerged from least developed country (LDC) status within one generation and is now a middle-income country. Foreign direct investment (FDI) was a driving force in this dramatic change. The Government's handling of the fiscal, social and economic pressures of this transformation could serve as a model for other resource-dependent economies.

Botswana aims to continue to grow rapidly and to diversify its economy, and for this the driving force should now be domestic business. However, the role of FDI will remain critical in all sectors in view of Botswana's continuing need for the various components of the FDI package, especially managerial, technical and professional skills, hard and soft technologies and access to, and knowledge of export markets. The current focus of the Government on national business development – through citizen empowerment – should not hold Botswana back from seizing opportunities to attract additional FDI and to benefit from it. That is the key message of this report.

Chapter I recapitulates the track record of Botswana in attracting FDI. Opened to FDI since independence, Botswana received large investment inflows relatively early. FDI has strongly boosted export receipts and government revenues which, invested wisely, created the foundations for long-term growth. However, as it has been concentrated in mining, FDI has had much less direct impact on employment. Linkages with the local economy appear to have been weak, one of the reasons being a dearth of local businesses. More importantly, being a package of resources, FDI has been critical in the first phase of the diversification of Botswana's economy from agriculture to mining. It has also contributed to the second phase of diversification, "beyond diamonds", but in general this phase remains an unfinished business and a challenge to the Government.

Chapter II reviews the investment framework for FDI. The general investment climate in Botswana is excellent in many respects. Botswana has never had a foreign investment law but has welcomed FDI in almost all areas and treated it well. Areas that are not yet serious impediments to investment but need pre-emptive action include work and residence permits, urban land availability and titles registration. However, the Government is now proposing a foreign investment code that would restrict FDI in a number of industries. This chapter suggests an alternative approach to the underlying issues. It makes a case for a modern foreign investment law consolidating the high standards of treatment and protection that Botswana has been giving to foreign investors, while at the same time dealing with Botswana's concerns in a constructive manner. In particular, care is needed to ensure that particular concerns, such as economic migration, are not handled in a way that detracts from Botswana's welcoming regime or good track record in dealing with important investor issues.

Chapter III argues that sustained FDI into all sectors will be needed to help achieve Botswana's national development objectives set out in Vision 2016: a long-term national development plan. But this requires a coherent FDI strategy rooted in Botswana's existing investment attractiveness due to its excellent governance, but embracing additional, more pro-active elements. These include: taking full advantage of market access arrangements; reinforcing such temporal advantages through attention to sustained long-term policy actions aimed at direct competitiveness factors; encouragement of local private business and the development of human resources; and ensuring coherence and consistency in Botswana's policies, including investment promotion efforts

Chapter IV highlights the main conclusions and recommendations.

I. FOREIGN DIRECT INVESTMENT:TRENDS AND IMPACT

Botswana has been open to foreign direct investment (FDI) since independence. This path – not often taken by others – produced results unmatched by any economy of similar size and level of development. Thanks to its success, for more than a decade Botswana has not had to depend on external capital inflows. But FDI is still needed for the other components that investment brings: technology, skills and access to export markets. The challenge is to enhance the contributions of FDI with complementary policies to build local capabilities and develop domestic enterprise.

A. Economic backdrop

Botswana stands out as the only graduate from the category of least developed countries (LDCs). At independence in 1966, it was one of the poorest countries of the world with an annual per capita income of less than \$100. After three decades of one of the fastest rates of economic growth in the world, Botswana is now an upper-middle-income developing economy with a per capita GNP of \$3 312. Its enormous progress was spearheaded by the discovery of rich and profitable deposits of diamonds in 1967, which initiated a process of structural change: from an economy heavily dependent on low productivity in agriculture to an economy where mining and services became the dominant sectors.¹ Botswana's accomplishments are not just a matter of good fortune. Substantial credit for its performance is owed to the wise management of natural resources and good governance, enabling political and economic stability to prevail. In the earlier years, much of its mineral revenue as well as foreign aid were invested in health, education and infrastructure, creating foundations for long-term growth. Equally important was that revenue which could not be invested sensibly was saved.² Botswana's early success, that has continued until today, has ensured a long-term macroeconomic environment conducive to a sound investment climate, a rare occurrence for a developing country.

Botswana also stands out in its choice of economic system and policies and attitudes towards FDI. During the 1960s and 1970s, State control, based on central planning, took firm hold in many African countries. Botswana, however, opted for a market-based system. It did not undertake widespread nationalization and it decided to exploit its most precious national resource – diamonds – in joint ventures with foreign investors. Banking, too, remained foreign-owned, even though many countries at that time considered them to be the main pillars of their economies. Since the creation of a national currency, the pula, in 1976, Botswana typically maintained more liberal exchange controls than its neighbours, including South Africa. All in all, Botswana has been open to FDI since independence and has constantly improved its FDI framework.

However, at independence Botswana hardly had any locational advantages. Its market was very small due to a small and poor population, living in rural areas and herding cattle as its main economic activity. As a member of the Southern African Customs Union (SACU), Botswana had free access to the large market of South Africa, but due to a lack of capabilities and infrastructure, it was unable to turn this access into a locational advantage. The discovery of diamonds (as well as copper, nickel and soda ash deposits) improved Botswana's attractiveness to foreign investors. The investment climate also improved due to prudent and, for that time, imaginative policies, combined with an increase in the supply of an urban labour force, improved skills and infrastructure and small, but fast growing, urban markets. All this took place very rapidly compared with many countries. By the early 1990s, 30 per cent of the

¹ In 1966, agriculture accounted for 39 per cent of GDP and mining for zero per cent. In 1999, these ratios were 3.6 and 45.4 per cent respectively. By 1980 the mining sector displaced the cattle sector as the main contributor to GDP.

² There were a few years in the late 1980s when this principle was abandoned, but the Government regained control of its spending before it was too late.

population lived in urban centres compared to only 4 per cent at independence. The number of university graduates increased to 3 100 from 22 during the same period, and the length of paved roads grew to 2 664 kilometres from 20 kilometres. A road system linking main towns, and dependable water, electricity and telecommunication services, existed in many parts of the country (World Bank, 1993:i).

Although the economic growth of 12 per cent per annum in the two decades after independence slowed down to single digits during the 1990s, Botswana has remained one of the most prosperous economies in Africa, with a consistently sound investment climate. A recent SADC investor survey of the investment climate in its member countries singled out Botswana as a “best practice” example on indicators of good governance, sound fiscal policies and high growth rates over a sustained period (Business Map, November 2000). In 2001 Botswana was awarded an A2 credit rating by Moody’s and an A by Standard and Poor’s in recognition of prudent fiscal and monetary policies resulting in a healthy balance of payments, sizeable foreign exchange reserves and budget surpluses (Financial Times, 2001)

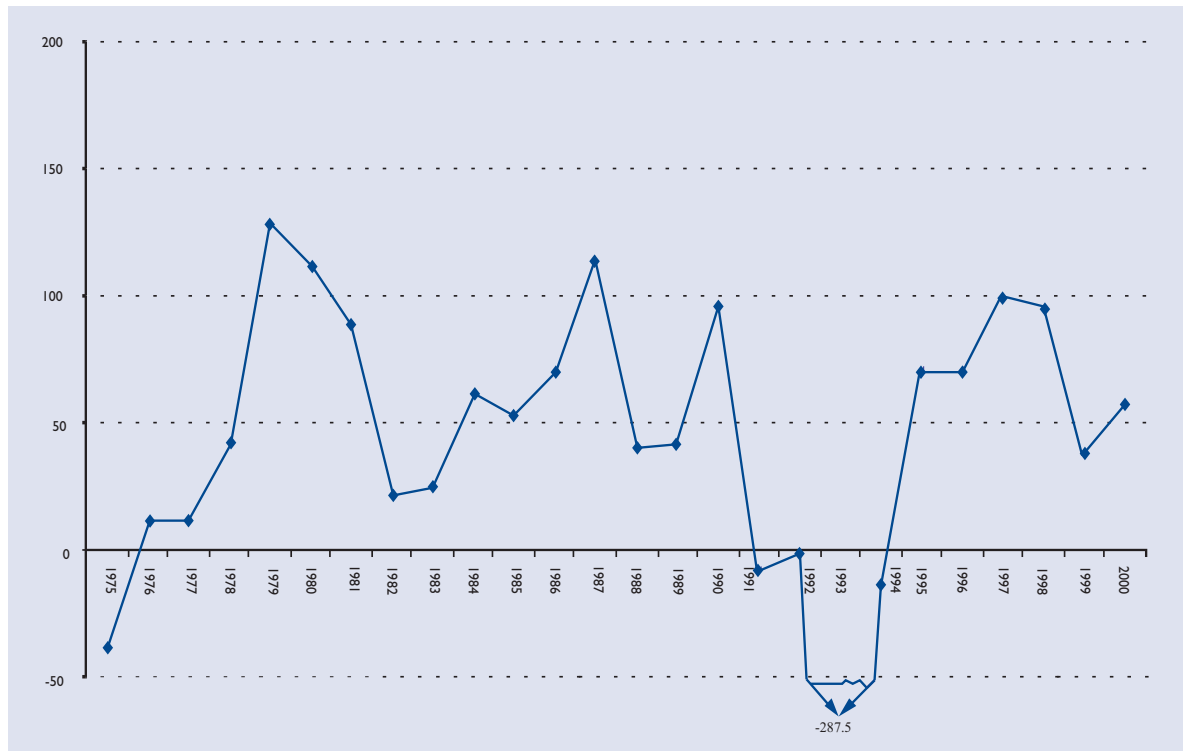
B. FDI trends

I. FDI size and growth

Botswana’s early opening to FDI was rewarded with large inflows of FDI in the 1970s. A record annual inflow, \$127 million, was registered in 1979. Between 1975 and 2000, flows based on five-year annual averages remained quite stable, hovering between \$50 million (during 1981–1985) and around \$70 million (in 1986–1990 and 1996–2000), except for the 1991–1995 period when they were negative (figure I.1). Very large negative flows occurred in 1993 (\$287 million) due to losses posted by a copper-nickel mine, BCL Ltd., and subsequent changes in its ownership (box I.1).

Figure I.1 FDI inflows into Botswana, 1975-2000

(Millions of dollars)



Source: UNCTAD, FDI/TNC database

Box I.1. Refinancing the losses of BCL Ltd.

BCL Ltd. was a joint venture between foreign investors – Anglo-American (with 40 per cent of the equity) and AMAX of the United States (29 per cent) – and the Government (31 per cent). Having been largely unprofitable, in the early 1990s the mine then suffered severe losses from falling international prices, which were financed largely by new loans from foreign shareholders. The reason for negative outflows in 1993 was the purchase of AMAX shares by the Government in a complex refinancing arrangement in which, among others, the Government acquired AMAX's paper claims on the assets of BCL. These included the accumulated losses (in large part the interest that had accumulated on the subordinated debt of BCL) that had been financed by shareholder loans. These claims were never expected to be realized. AMAX, by selling out, had discounted them considerably, along with its share of the other assets of BCL. Balance of payments rules require, however, that this be recorded as a capital outflow at the full face value of the loans. Correspondingly, in previous years, the shareholder loans, to cover decreases in shareholder equity, had been recorded as capital inflows (for example, this is understood to have accounted for the large inflow recorded for the year 2000). It should also be noted that the Government re-sold half of its acquired shares to Anglo-American.

Source: Bank of Botswana (1995).

On an annual basis, FDI inflows were lumpy, with peaks determined by investments in three diamond mines (the Orapa mine, the Jwaneng mine and the Letlhakane mine), and copper and nickel mines (such as the Tati nickel mine). Other large projects which produced “lumps” in the inflows included investment by South Africa in Soda Ash Botswana (SAB) (which accounted for the 1990 hike) and projects in the automobile and textile industries. More recently, however, with no shortage of local savings, liberalization of the capital account and further improvement in Botswana’s creditworthiness, the link between large FDI projects and FDI inflows has become weaker, as investors have a choice of many financing options generally unavailable in many other developing countries. A major expansion of the Orapa diamond mine during 1997–2000 contributed to an increase in FDI inflows, but this did not prevent overall FDI inflows falling from \$96 million in 1998 to \$30 million in 2000 (box I.2). If a planned doubling of the capacity of the Phoenix copper-nickel mine by the Tati Nickel Mining Company, announced in 2000, is financed through means other than FDI, this too will not be reflected in increased FDI inflows.

Box I.2. Financing FDI locally

The Orapa expansion doubled the production capacity of the largest diamond mine in Botswana, owned and operated by a foreign affiliate, Debswana Diamond Company, a 50-50 per cent joint venture between De Beers, a leading international diamond group, and the Government. The project involved a total investment of some \$320 million and was “the biggest capital project ever seen in Botswana”. Yet Botswana’s total FDI inflows (involving FDI by all foreign affiliates) during its realization were much smaller, \$263 million during the period 1997–2000. This apparent paradox arises from the methodology that is used to report FDI inflows.

FDI inflows are a balance-of-payments measure, comprising reinvested earnings of foreign affiliates and the financing of these affiliates by foreign parent companies in the form of loans or equity capital. They include neither financing through loans by affiliates from the local or international capital markets nor co-financing by local shareholders.

The Orapa expansion was financed largely by sources other than FDI. Nearly one-fifth of the project was financed by a cash injection by the foreign shareholder; through a loan raised by the De Beers Group from local banks. The balance was provided by both shareholders using reinvested profits, which would otherwise have been distributed to the owners. Only the foreign shareholder’s part in this reinvestment qualifies as FDI and, thus, only the contribution of De Beers has been recorded as increased FDI inflows into Botswana. On the other hand, the financing of a part of the project by the local shareholder, the Government, is not recorded as FDI. Assuming that both shareholders contributed reinvested earnings in equal proportions, it can be estimated that only 40 per cent of the total value of the project was financed through FDI, while the balance was financed by other means.

Sources: UNCTAD mission; *Sunday Times*, *Debswana gearing up and up*; *Business Times*, <http://www.btimes.co.za/97/0824/world/world2.htm>; *Botswana lends De Beers R455m*, *Daily Mail and Guardian*, *Business*, July 8 1999, <http://www.mg.co.za/mg/zalarchive/99jul/08julpm-business.html>.

Until the 1990s, Botswana received a disproportionately large amount of FDI as compared with the 14-member grouping of SADC to which it belongs,³ or the group of LDCs, to which it belonged at independence. During the 1990s Botswana lost its position vis-à-vis these countries. Its shares of FDI inflows and stocks fell considerably when

³ SADC members are Angola, Botswana, Democratic Republic of the Congo, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, United Republic of Tanzania, Zambia and Zimbabwe. The total population of SADC is 198 million (in 2000) and its GDP \$183 billion (in 1999). South Africa alone accounts for 20 per cent of SADC’s population and over 70 per cent of its GDP.

compared with its shares of GDP or population. For example, while Botswana's share of GDP of the SADC group increased from 2.7 per cent in 1990 to 3.3 per cent in 2000, its share of FDI inflows to SADC fell from one third in 1986-1990 to less than 2 per cent in 1996-2000 (table I.1).

One obvious reason why Botswana lost its share of FDI inflows was that the comparator countries opened up to FDI resulting in increased inflows, driven mainly by privatization programmes and/or mega projects in natural resources or their processing.⁴ Botswana has not yet started its privatization programme and, as mentioned above, its only major recent FDI project in natural resources – doubling the production capacity of the Orapa diamond mine, completed in 2000 – did not result in increased FDI inflows. In addition, the end of apartheid in 1994 brought South Africa back to the FDI scene and, after several years of divestment, attracted large FDI inflows in the second half of the 1990s. Furthermore, a number of South African companies with investments in Botswana returned to their home country.

Table I.1. FDI in Botswana compared with SADC and LDCs, 1975-2000
(per cent)

ITEM	SHARE OF BOTSWANA IN:					
	SADC			LDCS		
	1975	1990	2000	1975	1990	2000
GDP	0.6	2.7	3.3	0.5	2.4	2.4a
Population	0.75	0.8	0.8	0.2	0.3	0.3
FDI stocks	2	9	1.7	30	16	4
FDI flows (5 years)	60 ^b	32 ^c	1.5 ^d	15 ^b	12 ^c	1.5 ^d

Source: UNCTAD, FDI/TNC database.

a 1999

b 1976-1980

c 1986-1990

d 1996-2000

Another reason is that Botswana's performance was not strong. After the divestments of the early 1990s, in the second half of the 1990s FDI inflows increased; but after reaching a peak in 1997, they began falling again. The overall size of FDI inflows in the latter half of the 1990s was not too different from what it had been in the latter half of the 1980s (table I.2).

Botswana's FDI stock grew rapidly until 1990, levelled off during the 1990s, and then increased to \$1.9 billion in 2000 (figure I.2).⁵ Compared with other countries this produced a performance similar to that for FDI flows: strong until 1990 and weakening after that. For example, in 1990 Botswana's stock was sixth in size in Africa, while in 2000 it was only sixteenth and Botswana's share in the total stock of Africa more than halved during this period, from 3.3 per cent to 1.3 per cent (UNCTAD, 2001: 301-302).

⁴ These included a hydro-electric project in Lesotho, development of a gas field in Namibia, an aluminium smelter plant in Mozambique, investments in gold mining in the United Republic of Tanzania and a copper mine in Zambia.

⁵ The latest estimates for 2000 (Bank of Botswana, 2002) puts the stock figure at \$1.9 billion, up sharply from previous estimates. This is attributed mostly to enterprise indebtedness to parent companies and interest paid on that (UNCTAD interviews 2002).

Table 1.2.
Botswana's FDI flows and stocks compared to selected countries, 1986-2000
 (Dollars and per cent)

Country	ABSOLUTE PERFORMANCE						RELATIVE PERFORMANCE							
	FDI inflows per year		FDI Stock	FDI inflows per capita		FDI Stock	Per \$1000 GDP (Dollars)		As per cent of GFCF		Per capita (Dollars)	FDI Stock		
	1986-1990	1991-1995 ^{a)}	Millions of dollars	1986-1990	1991-1995 ^{a)}	1996-2000	1986-1990	1991-1995 ^{a)}	1986-1990	1991-1995 ^{a)}	1996-1999	2000		
BOTSWANA	72	12	72	61	8	46	31	2	14	16	7	1 183	36	
Lesotho ^{b)}	12	21	29	7	11	14	26	28	33	5,28	4	6	149	36
Mozambique	5	32	174	0	2	9	2	14	46	1	7	26	55	29
Nambia	7	122	105	6	83	64	4	41	34	6	22	16	952	53
South Africa	-73	468	1 515	-2	13	39	-1	3	11	0	2	7	1 304	42
U. R. Tanzania	0	53	171	0	2	5	0	11	22	0	5	14	35	13
Zambia	113	54	177	16	7	20	36	16	53	37	9	12	233	74
SADC*	281	1 333	3 909	2	8	21	2	7	21	1	4	12	366	42
SADC excluding South Africa	354	865	2 394	3	7	16	8	18	47	5	9	20	129	41
Africa excluding South Africa	2 894	4 046	7 326	5	6	10	9	13	18	4	7	9	125	21
LDCs	610	1 475	3 533	1	3	6	4	11	20	4	6	6	50	17
All DCs	27 858	80 167	197 872	7	19	42	9	17	32	4	6	11	409	30

Source: UNCTAD/FDI/TNC database; Bank of Botswana, Annual Report (2001).

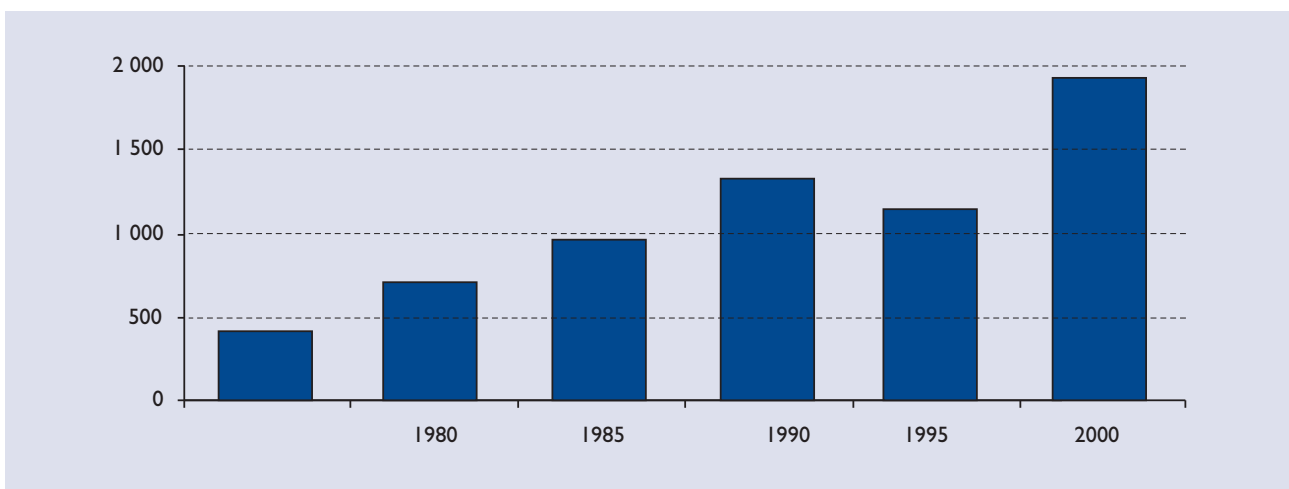
* SADC members: refer to footnote 3.

^{a)} Average (1991 – 1995); Average of 1991, 1992, 1994 and 1995.

^{b)} Lesotho's FDI series are direct investments data taken from the International Monetary Fund (various years).

However, as already mentioned and further discussed below, FDI flows and stocks do not fully reflect the quantitative significance of Botswana's FDI performance; unlike many developing countries, Botswana permits foreign firms to finance their investment through non-FDI forms such as loans from the domestic market, in addition to their wider access to international capital markets.

Figure I.2 Botswana: Inward FDI stock, 1975-2000
(Millions of dollars)



Source: UNCTAD, FDI/TNC database.

2. Distribution by sector and industry

Foreign direct investment in Botswana is concentrated in the mining sector, which accounted for 75 per cent of the FDI stock in 1999⁶. The bulk of investment in this sector is diamond mining by Debswana Diamond Company, a 50-50 per cent joint venture between the Government and De Beers, a leading international diamond group. Other significant mineral developments with foreign capital are copper/nickel mines operated by BCL Ltd, and Tati Nickel Ltd. The latter is a joint venture by Anglo-American Corporation, Lion Ore Ltd (a United Kingdom-registered company) and the Government.

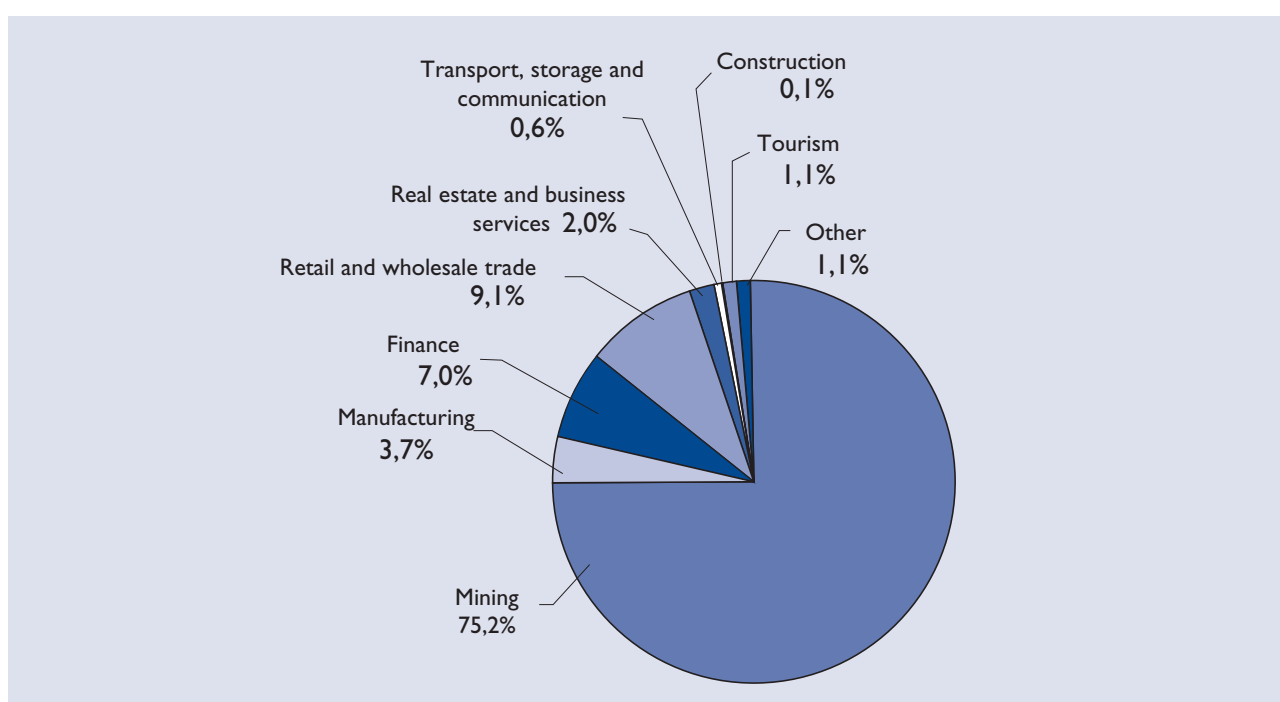
The second largest sector for FDI is services, accounting for 20 per cent of the stock. The largest activities for FDI within this sector are wholesale and retail trade (9.1 per cent) and financial services (7.1 per cent) (figure I.3). It is notable that while tourism is an important industry in the economy, accounting for 4 to 5 per cent of GDP, its share of the total FDI stock is only 1.1 per cent, in spite of the fact that most of the hotels and lodges in tourist regions are foreign-owned⁷.

⁶ The stock of FDI in mining and consequently its share in the total stock is, however, inflated by BCL's liabilities to its foreign shareholders, including unpaid loans and accrued interest. These liabilities account for 60 per cent of the mining sector's liabilities to direct investors. As explained in the Annual Report 1999 of the Bank of Botswana "most of this debt is unlikely to be repaid, but remains as a liability until the company and its creditors agree to, fully or partly, write-off the debt" (p. 63). The latest 2000 figures reinforce this.

⁷ Tourist operators are not allowed to build large modern hotels in the tourist regions. In the Okavango Delta, they must use local materials. As a result, accommodation is largely made of woods, grass and canvas.

Manufacturing, a sector which the Government targets in its diversification platform, accounted for only 3.7 per cent of the total FDI stock in 1999, in spite of the fact that for many years investment in this sector benefited from an incentives scheme, known as the Financial Assistance Policy (FAP). Generally, FDI into this sector has been in small-scale consumer industries, in response to niches in the domestic and regional markets. A number of projects were of a temporary nature because FAP turned out to be so generous that it was profitable for many investors, both foreign and domestic, to establish companies for the duration of the employment subsidy (five years), and to close them down once the subsidy expired. This is a major reason for the discontinuation of the FAP in 2001 (Bank of Botswana, 2001: 86).

Figure I.3. Stock of FDI by industry, 1999
(Per cent)



Source: Bank of Botswana (2001).

There are a few garment manufacturers from Asia and Mauritius which export to overseas markets, but they are also small firms. In the latter half of the 1990s, FDI in manufacturing received a boost from the establishment of a vehicle assembly plant by regional investors under franchise from Hyundai Motors of the Republic of Korea (box I.3), and of the Haltec Garment Company, with major shareholdings by Indonesians. The Motor Company of Botswana employed about 600 people and assembled cars for export to the regional market, mainly South Africa; while Haltec had about 1 000 employees. Both operations closed down in 2000.

Box I.3. Motor Company of Botswana

A greenfield plant costing \$60 million was built in Gaborone in 1997 to assemble Hyundai motor cars from completely knocked-down kits, for sale to South Africa. The foreign investors concerned already held the Hyundai franchise in a Botswana plant to produce these vehicles from semi-knocked-down components. They also controlled the South African distributor of the vehicles. The Motor Company of Botswana (Pty) Limited (MCB) was incorporated to own the venture. Its principals were a Zimbabwe businessman with interests in South Africa and a United Kingdom businessman. Hyundai was not the operator, but supplied kits for assembly under franchise.

MCB did not obtain FAP grants or the concessional corporate tax rate for manufacturing. It acquired a large industrial site from the Government and a loan of about \$24 million from a parastatal, the Botswana Development Corporation (BDC). Two Dutch banks provided credit of another \$24 million.

In 2000, MCB failed, resulting in 600 job losses. It had produced only 7 000 units over two years compared with a required break-even level of 15 000 per year. Loans were not repaid and BDC was burdened with interest arrears. It is probable that Hyundai too was left with large trade credits on the supply of kits. The affiliated South African distributor also collapsed and there have been persistent allegations of fraud against the principals. MCB has become a byword in Botswana for the “fly-by-night” foreign investor

Source: UNCTAD.

Towards the end of the 1990s, the Government intensified efforts to attract FDI into export-oriented manufacturing as part of its Industrial Development Policy, revised in 1997. These included upgrading and intensifying investment promotion efforts through the establishment of the Botswana Export Development and Investment Agency (BEDIA). This agency replaced the Trade Investment and Promotion Agency, which had limited powers and resources. Although the FAP scheme was discontinued, manufacturing continues to enjoy a low corporate tax rate of 15 per cent (compared to the regular rate of 25 per cent) (*Economist Intelligence Unit*, (2001: 19).⁸ Recent information shows the different types of manufacturing activities of the new foreign investors (table I.3). Of the six foreign manufacturing affiliates, two are garment exporters from Asia and one is from Mauritius.

3. Types of FDI

Until recently, most FDI projects have been greenfield. This may change with the implementation of the privatization programme approved by Parliament in April 2000. The Government intends to privatize companies in the telecommunications, agriculture, housing and transport industries, and foreign investors will be permitted to participate. In 2000, Air Botswana was the first company to be put up for sale, but the sale was not carried through owing to unfavourable market conditions.

⁸ Low tax will not affect South African investors, because in 2000 South Africa changed its taxation system from source-based to residence-based to mitigate tax losses from South African companies taking advantage of tax breaks elsewhere.

Table I.3. Botswana: New FDI projects in manufacturing, 2000-2001

FOREIGN AFFILIATE	COUNTRY OF ORIGIN	PRODUCT	INVESTMENT (\$ MILLION)	EMPLOYMENT	EXPORT MARKET
Auto Ancillaries Ltd. ^a	India	Leaf springs for vehicles	1.8	50	Regional market
B&M Garments	Mauritius	Garments	3.1	700	Sweden, Germany and the United States
Dinkie	Zimbabwe and the United Kingdom	Steel toes caps	..	50	Local market
Protecto Quip	Zimbabwe	Shoes	0.2	50	..
Rising Sun	China	Garments	0.8 ^b	550	South Africa. Plans to export to the European Union and the United States
Star Apparels	Sri Lanka	Garments	2.0	400	European Union and the United States

Source: Botswana Export Development and Investment Authority.

^a Joint venture

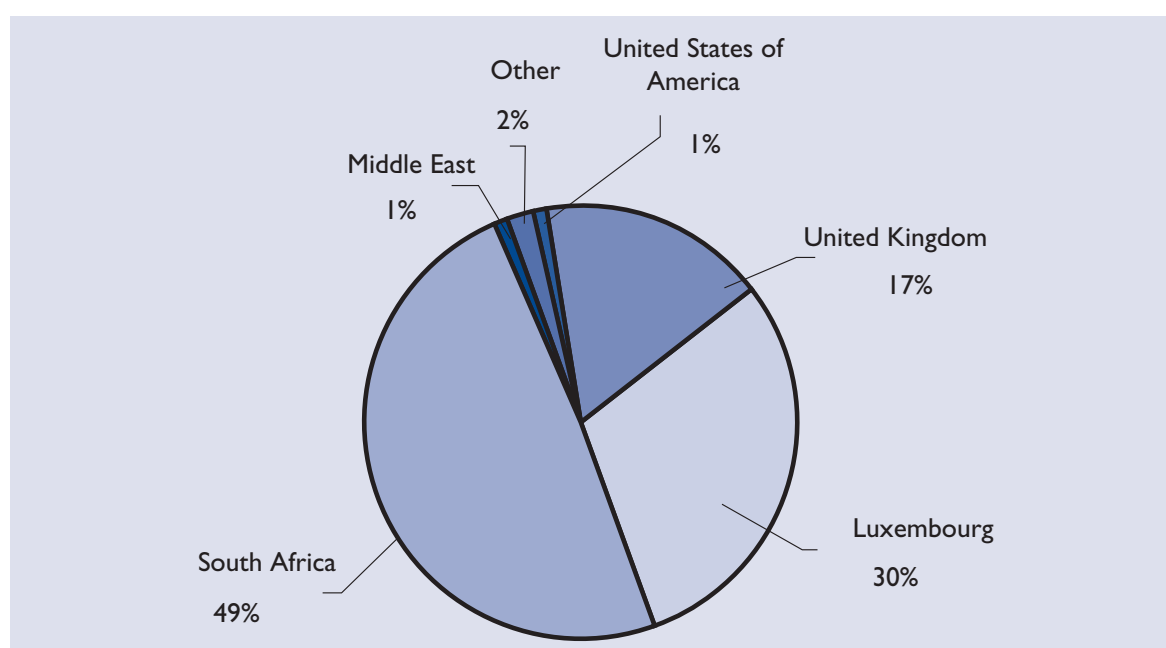
^b Investment in machinery

4. Countries of origin

South Africa is the largest home country for FDI in Botswana, accounting for almost half the FDI (figure I.4). This reflects the proximity and traditional close economic links between the two countries. While the bulk of South African investments are in diamond mining, they also include wholesale and retail trade, construction, property development and financial services.

The second largest home country (30 per cent of the stock) is Luxembourg. This is attributable to investment by De Beers' subsidiary company domiciled in Luxembourg. The proportion of FDI from the United Kingdom is also quite considerable, focusing on the banking industry and other service industries (table I.4). The United States has a very small presence in Botswana: only 1 per cent of total FDI. The few known foreign garment manufacturers from Asia are included among the 2 per cent of investors in the "other countries" category.

Figure I.4. Stock of FDI by the country of origin, 1999
(Per cent)



Source: Bank of Botswana (2001)

Table I.4. Major foreign affiliates in Botswana
(Millions of dollars and number)

FOREIGN AFFILIATE	HOME COUNTRY	INDUSTRY	ASSETS OR SALES (\$ MILLION)	NUMBER OF EMPLOYEES
Debswana Diamond Company	South Africa	Mining	1 994 ^a	6 000
Barclays Bank	United Kingdom	Banking	435 ^b	850
First National Bank	South Africa	Banking	245 ^b	..
Standard Chartered Bank	United Kingdom	Banking	193 ^b	571
Botswana Insurance Holdings	South Africa	Insurance	..	400
Kentz	Malaysia	Construction	..	225
Stanbic Bank	United Kingdom	Banking	144 ^c	177
Blackwood Hodge	United Kingdom	Construction	..	53
Manica	United States	Transport	..	45

Source: UNCTAD, FDI/TNC database; Debswana Diamond Company, Annual Report 2000; and Stockbrokers Botswana Ltd.

^a Sales in 2000.

^b Assets in 2001.

^c Assets in 1999

5. Relative importance of FDI in the economy

The sluggish nature of FDI growth during the 1990s should not overshadow the role it has played in Botswana's economy in both quantitative and, more importantly, qualitative terms (section C). Foreign firms came to play a significant role in many sectors and industries early in Botswana's development effort. In partnership with the Government, they developed the mining sector. The manufacturing sector, although small, was also developed with a high level of participation of FDI. In 1984, over 60 per cent of all establishments in the manufacturing sector were wholly foreign-owned (Lewis and Sharpley, 1988: 7). Current figures for the sector are not available, but estimates for individual industries indicate that the role of FDI is most likely, to be even greater today, with the notable exception of the meat industry (table I.5). In the services sector, commercial banks have always been foreign-owned or controlled. Other service industries with a high presence of foreign firms include insurance and business services. Foreign firms are also prominent in road transportation, wholesale trading and construction. In tourism, out of a total of 331 enterprises licensed and operating between March 1997 and February 2001, more than two thirds were foreign, with half of these being joint ventures with local partners (Department of Tourism of Botswana). In addition, a number of foreign firms have naturalized over the years. On the other hand the local private sector, especially in manufacturing, has always been rather weak. This poses one of the most formidable challenges to Botswana's development, which, thus far, has been driven mainly by large State-owned and foreign firms

Table I.5. The estimated importance of foreign affiliates in manufacturing, 2000
(Per cent)

INDUSTRY	SHARE OF FOREIGN AFFILIATES IN INDUSTRIES	
	Sales	Exports
Meat and meat products	5-10	5-10
Dairy products	70-85	0
Bakeries	60-65	0
Beverages	90-95	0
Textiles	90-95	90-95
Clothing and other apparel	55-70	90-95
Leather	70-80	90-95
Wood	70-80	90-95
Paper	80-90	90-95
Chemical	50-65	50-60
Rubber and plastic	80-90	90-95
Metal	70-80	80-90
Other	60-70	70-80

Source: Department of Industrial Affairs.
a Companies with foreign ownership of at least 10 per cent.

Comparisons with other countries, based on the ratio of FDI stock to GDP, do not indicate that the participation of foreign firms in Botswana's economy is excessively or unusually high. The ratio of 23 per cent in 1999, is considerably smaller than the average ratio for SADC countries and smaller than the average for developing countries (table I.2). It is, admittedly, underestimated because of the high incidence of joint ventures with national interests in mining.⁹ But even if this were to be doubled, the ratio would still be much smaller than it is for other countries in the development of which FDI has been known to play a significant role such as Singapore (97 per cent), Malaysia (65 per cent) and Ireland (51 per cent) (UNCTAD, 2001: 325-337).¹⁰ It would also be below the ratios in Namibia, Lesotho and Zambia. In terms of FDI stock per capita, Botswana remains clearly behind such countries in the region as South Africa, Namibia and Lesotho (table I.2).

⁹ If all foreign firms were 50-50 per cent joint ventures, this would mean that the share of assets controlled by foreign investors in GDP would be twice as high as what the ratio indicates.

¹⁰ It should be noted that this ratio was much higher during the initial period after independence (70 per cent in the first half of the 1980s), pointing to the fact that the relative importance of FDI in Botswana's development has diminished over time.

C. Impact of FDI

Measures of FDI performance, such as FDI inflows and stock, do not provide a full picture of the quantitative significance of FDI in Botswana's economy, which is much greater than these measures suggest. This observation applies even more so to the qualitative impact of FDI on Botswana's economy. Botswana has relied considerably for its development on all components of the FDI package, including capital investment, technology, access to markets, and all types of skills (e.g. managerial, technical, professional and organizational skills). More recently, there has been a shift in the importance of the components of the FDI package, from the provision of financial resources towards other key components for the establishment of production entities, among which technology and skills are particularly important.

I. Capital and investment

Botswana is in the unusual position among African and many other developing countries in that, since the second half of the 1980s, its domestic savings ratio has consistently exceeded its investment ratio by a large margin. Moreover, this has occurred in spite of the fact that Botswana's investment ratio has been among the highest in Africa (table I.6). High national savings allow Botswana to co-finance FDI-sponsored investment through domestic lending (e.g. financing the expansion of a diamond mine) and through equity (although mainly through government equity, because most savings are in the public sector and the equity market is still very weak). The high credit rating recently accorded to Botswana should facilitate access of Botswana's companies – local and foreign – to loans from international credit institutions, both private and public.¹¹

Although FDI is not as important a source of finance for investment in Botswana as in other developing countries, it plays a significant, and, in some industries, critical, role as a catalyst in encouraging new investment, and sustaining present investment at the high levels that the country has enjoyed. During the past decade, the share of foreign firms in Botswana's investment is estimated at well over one third of gross fixed capital formation (in constant prices) (Government of Botswana, 2000a: 44).¹² Foreign affiliates in mining alone accounted for some 15 per cent of total investment. As local entrepreneurship is still in its infancy, FDI has also remained a crucial factor for identifying viable investment projects in small-scale manufacturing and services, assessing and taking investment risks, and bringing together and managing the ingredients necessary for successful investment.

¹¹ There are, however, differences between access to international credit for large, local, State-owned companies (the dominating form of local enterprises) and that for local small and medium-sized enterprises (SMEs), for which such credit is very difficult, if at all possible, to obtain. SMEs' access to local savings, which are high, should be less difficult, but it should be kept in mind that these savings are dominated by the public sector and a large proportion of them is invested as a budgetary and foreign exchange reserve. A new incentives scheme, a fund administered by the Citizen Entrepreneurial Development Agency, is designed to facilitate credit for local SMEs.

¹² The decade refers to 1991-1999. The share of over one third refers to the share in total investment in sectors where foreign firms (that is, firms wholly or partly foreign-owned) are the only firms or firms that play a major role. This includes mining, financial and business services, trade, hotels and restaurants, and manufacturing. The share is overestimated, especially in manufacturing and small trading services where local firms are also present; on the other hand, it is underestimated by the exclusion of transportation and construction, where foreign firms play a significant role.

Table I.6. Savings and investment ratios, Botswana and Africa, 1975-2000
(Per cent)

PERIOD	BOTSWANA		AFRICA	
	Savings ratio	Investment ratio	Savings ratio	Investment ratio
1975-1979	17	36	21	26
1980-1985	26	35	18	21
1985-1989	49	25	21	21
1990-1994	37	29	17	19
1995-1999	30	23	17	20
2000	33	21	19	20

Source: The World Bank, *African Development Indicators* (various issues); and United Nations, *African Development Report* (various issues).
a Gross domestic savings and gross domestic investment as per cent of GDP.

2. Technology and skills

As regards technology, the manufacturing sector remains weak and Botswana has not yet been able to create significant local technology capabilities or institutions. Therefore any investment project involves imports of capital goods and associated technology. This also concerns low-technology manufacturing, especially export-oriented, where FDI contributions include simple (but not yet existing in Botswana) technologies, skills and access to foreign markets (box I.4). In mining, foreign investors make sure the technology is updated to maintain the long-term competitiveness of mines – a factor that sustains the positive indirect financial contributions of FDI to the economy in the form of taxes, royalties and dividends of local shareholders.

Regarding skills, even though Botswana has invested heavily in education, it has a deficit of skills. The education system was for many years biased towards the needs of the public sector and neglected those of the private sector and professions (including the needs of the mining sector, the first engine of Botswana's development).¹³ In this situation FDI is a key source of all types of skills, through employment of expatriates, training of the local workforce, and the movement of skilled trained labour from foreign affiliates to local companies. The use of expatriates has been common in all sectors of the economy, including the public sector: foreign experts are employed not only in technical and managerial positions in State-owned enterprises, but also in the Government and at the Bank of Botswana. As for training, there are indications that many foreign investors do indeed train their employees for various types of skills, although with varying intensity. In manufacturing, training seems to concentrate more on unskilled labour (box I.4). In human-capital-intensive service industries such as banking it involves both low- and high-skilled positions. Some foreign banks have targets for the replacement of expatriates in high positions with local qualified staff (box I.5). The example of mining shows that the turnover of skilled employees, trained by the mines at considerable expense, can be quite significant. For example, according to Gaolathe (1997:412 – 413) "Debswana has lost nearly one quarter of all the skilled, technical and professional manpower it trained between 1969 and 1996". The HIV/AIDS epidemic is exacerbating the skills deficit and increasing the costs of training. One investor interviewed is losing at least one skilled member of staff every month due to death from HIV/AIDS.

¹³ The faculty of engineering was established at the University of Botswana only in 1995, incorporating the previously existing technical college as part of the University.

Box I.4. The Impact of FDI in export-oriented manufacturing in Botswana

Auto Ancillaries Botswana (Pty) Ltd. (AAB), a majority-Indian-owned (60 per cent) joint venture, became operational in June 2001. The company has other production affiliates in Dubai, Kenya and India. Caratex (Botswana), established in 1998, is a joint venture with investments from Taiwan, Province of China. Its other operations are located in China, Hong Kong (China) and Taiwan, Province of China. They bring to Botswana the following package of assets indispensable for exports:

New products. AAB will produce high quality laminated leaf springs and assemblies for trailers, trucks, passenger cars and jeeps. Caratex produces sweaters and jerseys. Neither of these products were produced in Botswana until the two firms entered the country.

Technology. As Botswana has neither a machinery nor equipment industry, the technology and know-how to manufacture leaf springs and sweaters had to be imported. In both cases investors brought state-of-the-art machinery, inputs have to be imported, too, as they are not available in Botswana.

Market access. More importantly, both investors brought with them access to new markets. AAB will market only 20 per cent of its production in Botswana, exporting the balance to other countries in the region, particularly to South Africa (50 per cent of the total), as well as Zambia and Namibia. In the future it intends to export its products to the European Union (EU). When it reaches full capacity, it expects exports to reach around \$1.2 million per annum. Caratex exports its entire production, valued at \$5 million: 70 per cent to the EU, where it supplies department stores such as Bon Marché and C&A; 20 per cent to North America; and 10 per cent to South Africa.. It intends to double its exports within three years.

Training and jobs. AAB plans to employ 125 workers when it reaches full production capacity. They will be trained by eight expatriate technicians in the company. Caratex has created 1 200 jobs and intends to increase their number to 1 500 in the next few years. After its establishment, the company spent six months training its workers before production could start. As employees are young women and turnover of staff is considerable, Caratex has a training section with three trainers preparing 32 trainees for new jobs per week.

Organizational and managerial practices. To set up the factories, both investors initially brought in professional teams of expatriates to organize production, install the machinery, train local staff and plan and manage the daily operations. Over time, as local organizational and managerial skills have been developed, the number of expatriates has declined. Caratex Botswana has been able to reduce the number of expatriates from 33 to 22. AAB, which is still in the establishment phase, also intends to reduce the number of expatriates.

Capital and investment. AAB invested about \$1.75 million, of which 60 per cent came from abroad; and Caratex invested about \$ 3 million, all of which was in the form of foreign capital. Over half of the capital inflows have been invested in machinery and equipment. A more important contribution is the investment itself, that is, identifying investment opportunities in Botswana, taking necessary risks associated with investment, and combining and organizing resources into viable investment projects.

Free or privileged access to international markets has been a very important reason for locating in Botswana for both investors. AAB underlined the importance of access to the South African market through the Southern African Customs Union (SACU), and to other African countries' markets through the SADC regional integration scheme. Caratex is taking advantage of duty- and quota-free access to EU markets under the Cotonou Agreement. It also sees significant potential for exports to the United States under the African Growth and Opportunities Act (AGOA) that provides a reduction in customs duty from 34 per cent to 1.5–3.0 per cent on imports from qualifying African countries (which includes Botswana). Furthermore, the friendly investment environment in Botswana, as distinct from other locations, is also highly rated owing to Botswana's domestic political and economic stability and stable currency with no foreign exchange restrictions, an absence of labour problems and crime, the availability of unskilled but trainable labour, and the general absence of economic problems.

Source: UNCTAD field interview.

Box I.5. Transfer of skills in banking

FDI in banking has been an effective way to help rectify skills shortages, a chronic problem facing all new industries in Botswana. For instance, management skills are boosted as most foreign banks have explicit policies of reducing their reliance on expatriate managers and promoting local expertise. Barclays Botswana, for example, states that the target for every expatriate is to train themselves out of their job, with the goal for training their successors within three to five years. (This programme of localization is further accelerated by the bank's policy of standardizing procedures across all its African operations, under the overall supervision of Barclays Africa headquarters). Reflecting these trends, most banks have initiated programmes of in-house training, in both domestic and international offices, where staff use different and sophisticated technologies and processes, and experience the international competitive pressures under which TNCs operate. Training is also organized more formally. For example, Standard Chartered Bank instituted a special financial services course for its employees at the international business school, INSEAD in France. Skills can also be transferred when local staff leave their international employer to join, or head, domestic enterprises. For example, a Botswana employee working in Barclays Africa's London office returned to Botswana, to join the newly established, government-promoted, International Financial Services Centre. This new centre has created linkages with the local accountancy college, and its five local employees now collate financial data for all of Africa. The skills and expertise disseminated through this new project may well stimulate other, similar, kinds of investment. Other benefits may be dispersed through informal networks, where, for example, Botswana nationals use newly-gained accountancy skills to benefit local community groups or the church.

Source: UNCTAD interview.

As a result of the growing supply of local skills and training effort, there has been in many foreign firms a clear long-term trend towards “localization” of skilled positions, including managerial positions. But in some quarters progress is considered too slow, aggravated by the recent increase in illegal immigration into Botswana as a result of problems in neighbouring countries and Botswana’s relatively high living standards. In response, there is a growing temptation to accelerate “localization” in companies, both foreign and local, and to deal with immigration issues through administrative measures and restrictive policies, combining in one policy package both FDI and immigration issues. If not designed properly, such policies, discussed in subsequent chapters, could reduce the role of FDI as an important source of the skills and technology in constantly high demand in Botswana’s economy.

3. Employment and linkages

FDI has not been as important a force in overall employment generation as in its contribution to the growth of production, exports and government revenues. The reason is that most FDI has been in large-scale mining, which is typically capital-intensive. Thus mining accounts for one third of GDP and three quarters of the total stock of FDI in Botswana, but it generates only 3.5 per cent of total employment. Finance and business services, where foreign firms play a major role, account for some 7 per cent of total employment, but the number of employees has not changed since 1994. Foreign banks are one of the largest employers, with

about 2 000 people, or one third of the number employed in mining. Most employees are local; for example Barclays Botswana estimates that fewer than 10 of the 900 staff employed at its 25 branches are expatriates.¹⁵ In manufacturing, where foreign firms play a significant role, employment has increased since 1994, from some 22 000 to over 28 000 in 2000, increasing the share of this sector in total employment from 9 to 11 per cent. However, as already noted, there has been a considerable loss of jobs with the closure of two plants in 2001, preceded by a history of earlier closures of both local and foreign-owned plants.

Linkages are another area where the impact of FDI has been weak in Botswana and a source of some frustration for government policy makers, although reasons for weak linkages are complex. There is a dearth of local suppliers to provide backward linkages for foreign investors. Government efforts to promote local entrepreneurship have not proved to be particularly effective.

Mining, which is the largest economic sector, still relies heavily on imported supplies and equipment and there is no industry cluster built around this sector. The largest mining companies typically have import content ratios higher than the average for the entire economy. In diamond mining, the import content of purchases of goods and services was at a constant level of 60 per cent between 1980 and 1995, while that of the coal mine, Morupule Colliery, was even higher at 70 per cent. But the copper-nickel BCL mine and Botswana Ash had a lower import content of 35-40 per cent in 1995 (Gaolathe, 1997:414-416). Encouraged by a shift in government policy and increasing pressure, mining companies are looking more and more at the possibility of replacing foreign suppliers with local ones and at developing programmes aimed at helping to establish local firms as potential suppliers to foreign affiliates (box 1.6). Thus the mining industry is beginning to outsource its requirements for goods and services. These include skilled paid professional services provided by former employees. Linkages are also being strongly encouraged in the tourism industry, and in banking, Barclays Africa estimates, for example, that 60 per cent of its costs are dispersed through the local economy.

Box 1.6. Encouraging local entrepreneurship

Peo Holdings Ltd., a company established in 1997, is an initiative of Debswana Diamond Company, which has become committed to assisting the development of commercially viable and profitable local enterprises. It provides financial and technical assistance to a number of small- and medium-sized projects managed by local entrepreneurs.

Local enterprises can seek seed money from Peo Holdings Ltd. in the form of minority shareholdings, as well as loan financing and technical assistance. Peo Holdings Ltd. sees this involvement as a significant contribution to other important objectives, namely employment creation, transfer of skills, citizen empowerment and diversification of the economy.

The beneficiaries of the initiative have included, among others, an Internet outlet in Gaborone, run by four young Botswana entrepreneurs, small bakeries, butcheries and fabrication workshops, with an investment of about US\$ 170 000. An agro-industry project at Pandamatenga has also received assistance of about US\$ 2 million. About 1 500 hectares has been planted with sorghum, cotton and sunflower.

Source: Debswana Diamond Co., (1999) and UNCTAD mission.

¹⁵ This is a lower proportion to total employment than in all of Africa where, according to Barclays Africa's estimates, 100 of 7 000 employees are expatriates (UNCTAD interview, London, November 2000).

Regarding forward linkages, there has been some progress in mining, especially in diamond mining. Since 1974, the sorting and valuing of diamonds, carried out in London for a fee, has been transferred to Botswana Diamond Valuing Company, employing some 500 Botswana nationals trained by expatriates, only 19 of whom remained by the mid-1990s (Gaolathe, 1997: 417). Three diamond polishing and cutting factories have also been established by foreign investors. Processing diamonds for the low end of the market, they have faced fierce competition from other low-cost diamond cutting countries such as India, and it is by no means clear that they have any advantages against their competition. One possibility would be to move up to the middle segment of the market, but skills required for such upgrading do not yet exist in Botswana. There is also some processing or local use in other mining industries. Copper-nickel ore is processed into copper-nickel matte (which is sent for refining abroad) and coal is used locally by a power station, smelter and soda ash works. Soda ash and sodium chloride are also refined in Botswana.

4. Diversification of output and exports

Botswana's economic strategy since independence has been directed towards rapid growth sustained by economic diversification: "first beyond beef and later beyond diamonds". (Bank of Botswana, 1995: 35). An important part of this strategy has been diversification towards export-oriented goods and services industries. At independence, the drive to export was motivated by the fact that almost "anything consumed was imported" and foreign exchange earning activities were needed to pay the import bill (UNCTAD/UNDP, 2000: 17). Furthermore, given the very small size of Botswana's economy, the potential for diversification towards import-substituting goods and services was very limited. Nowadays, it is acknowledged that "economic growth driven by diamonds export revenues (and government spending) cannot continue indefinitely" (UNCTAD/UNDP, 2000: 51). In addition, diamond mining and other mining does not create many jobs and cannot significantly reduce unemployment, which has been a problem in Botswana for some time. FDI contributed considerably to the first phase of the diversification process. It has also made contributions to the second phase, which is not yet completed and poses a difficult challenge to the Government.

FDI in diamond mining has been the dominant force in the growth and diversification of Botswana's economy¹⁶ and exports, helping it to move away from dependence on the production and exports of beef. Initially "beef was almost the only visible export, and almost the only domestically produced commodity that was also consumed within Botswana" (UNCTAD/UNDP, 2000: 17). The large trade deficit that remained despite beef exports was financed by the remittances of migrant mine-workers in South Africa and by foreign aid. As the production and export of diamonds developed, the trade deficit gradually decreased, disappearing completely by the early 1980s. From a zero level at independence, diamonds accounted for 14 per cent of Botswana's exports by 1970 and 75 per cent by the mid-1980s. Fluctuating since that time between 70 and 85 per cent of total exports, they have been a major component of the country's total exports – which increased more than fivefold between 1980 and 2000 – and a driving force for the entire economy, despite some progress in the second phase of diversification.

The second phase of diversification, beyond diamonds, has proved to be much more difficult than the first phase, away from beef. Progress has been achieved in some aspects of further diversification and FDI has played a substantial role. Since 1984, when the share of the mining sector (dominated by diamond mining) peaked at 51 per cent, the rapidly growing economy has clearly diversified towards services, especially commercial services (the share of which increased from 24 per cent that year to 44 per cent in 2000), while the share of mining declined to one third of GDP.¹⁷ Service industries in which FDI plays a major or dominant role have been at the forefront of the

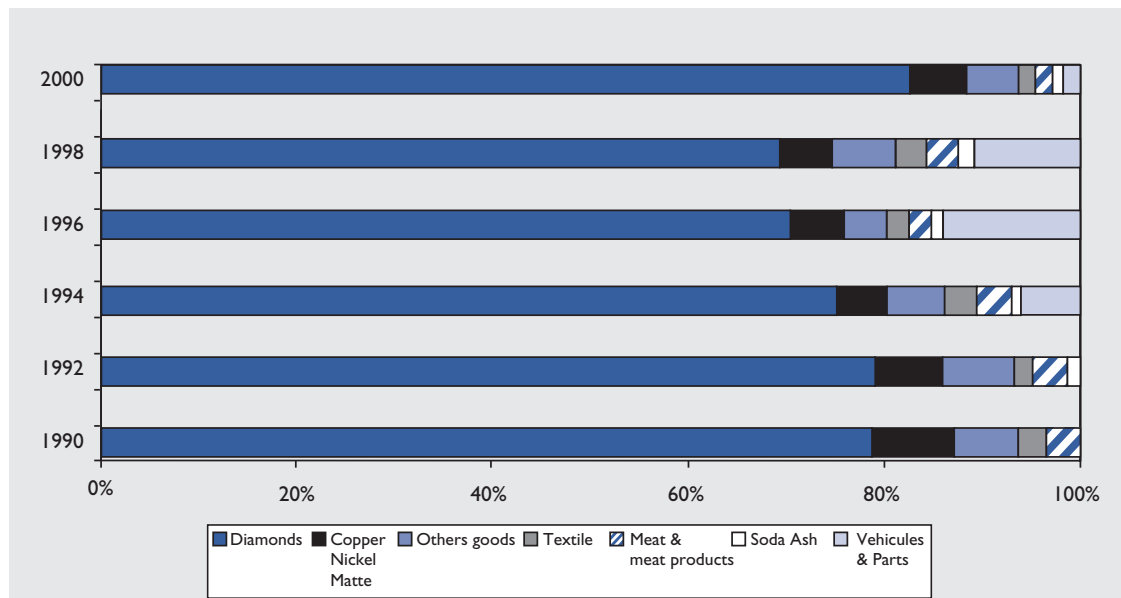
¹⁶ As noted by Matsheka (2000: 16): "the development of the mining industry could not have taken place without large inflows of capital, in the form of foreign direct investment ... because the Botswana government did not have the capacity nor the resources to develop the mining industry on its own".

¹⁷ Data on diversification come from annual reports of the Bank of Botswana, if not otherwise indicated.

rapid change. For example, the share of banking, insurance and business services has more than doubled during the period, from some 5 per cent in 1984 to almost 11 per cent in 2000. State-owned enterprises have also contributed significantly to diversification, developing infrastructure services such as water and electricity, transportation and telecommunications. In spite of special efforts (such as FAP) no progress has been achieved in the diversification of manufacturing, the share of which declined slightly from 5 per cent to 4 per cent during the period 1990-2000. This decrease should not, however, conceal the fact that the sector grew rapidly, doubling its production between 1984 and 1990, and increasing it further by half in 2000.¹⁸ As noted earlier, FDI has played a major role in its expansion. As a result of the second phase of diversification, the ratio of imports to GDP, which did not change during the first phase, has fallen from nearly 60 per cent in the mid-1980s to 40 per cent in 2000 (UNCTAD/UNDP, 2000: 2 and 53). The growth of manufacturing, which has been partly export oriented and partly import substituting has contributed to this reduction.

It is the external aspect of diversification – seeking new sources of sustainable foreign exchange earnings beyond diamonds – that has proved to be the most difficult, even though the contribution of FDI to this area has been greater than to the diversification of production. In the year 2000, diamonds accounted for the same share of exports of goods as in 1990: nearly 80 per cent. This share was temporarily “lost” in the mid-1990s to the automotive vehicles and parts category (figure 1.5) but was recovered after the closure of the automobile plant of the Motor Company of Botswana.¹⁹ It will most likely increase further, following the doubling of the capacity of the Orapa diamond mine completed in 2000. It should, however, be noted that given the very rapid increase in diamond exports, non-traditional exports have kept up remarkably well, maintaining their share of total exports. This has been helped, except for very recently, by an exchange rate policy conducive to maintaining export competitiveness.

Figure 1.5. Botswana: composition of exports by major categories, 1990-2000
(Per cent)



Source: Central Statistical Office, Botswana.

¹⁸ The underlying point is that any sector or industry which kept up, as the manufacturing sector did, with the extraordinarily rapid growth of mining was really doing very well.

¹⁹ It should be noted, however, that although the plant made a difference in export composition for 3 to 4 years, its contribution to the trade balance was overshadowed by its import content of 85 per cent. Most manufactured exports have a high import content in Botswana, but not quite of this scale.

FDI plays a significant or major roles in all other export categories. Thus, at this stage, when export capabilities of local enterprises are still rather weak, without FDI, export dependence on diamonds would probably be even greater. FDI has supported the development of other mineral exports, in particular copper, nickel and soda ash (nearly 6 per cent of exports at present). In manufacturing, which accounts for less than 10 per cent of Botswana's exports, FDI has created most of the new capacity to produce goods for export across the entire range of industries, based on Botswana's preferential access to regional and overseas markets. Except for the beef industry, where the Botswana Meat Commission is the only exporter, and food and beverage industries, which are oriented to the local market, the share of FDI in exports of other industries is very high; in many industries it exceeds 90 per cent (table I.5). The aggregate impact on total exports of these industries is small (especially after the closure of the automobile factory) but FDI has been important because it has introduced Botswana to new markets, new products and new technologies. Although these products and technologies are often rather simple ones, they have never before been produced or used in Botswana. Box I.4 describes the experiences of two such foreign investments. Another important contribution of FDI to the diversification of the external sector is its share in tourism receipts, which have grown rapidly, doubling from \$117 million in 1990 to \$223 million in 2000. Foreign affiliates play a major role in the segment of the tourism industry that caters to foreign tourists. Other services exports have so far been negligible, but the International Financial Services Centre has been created recently, with some early success as a vehicle to attract FDI to Botswana as a base for the export of financial and related business services.

D. Assessment

FDI has played a central role in transforming Botswana, since national independence, from a poor to a middle-income developing country, by contributing resources necessary for development, which Botswana – one of the poorest countries in the world at independence – did not have. These included foreign savings and foreign exchange, technology, managerial, technical and professional skills, capabilities and access to international markets and marketing channels. With the rapidly changing needs of the dynamically expanding and progressing economy, some of these contributions soon became less important, especially capital. The importance of other contributions, especially technology and skills, remained high, although they shifted among sectors: from mining to the services and manufacturing sectors. In some areas such as employment, the impact of FDI has been less dramatic. Linkages with locally-owned businesses – a source of FDI contributions -- appear to have been weak, one of the reasons being a dearth of such businesses.

More importantly, however, FDI contributions have gone far beyond individual areas such as technology or capital. Being a package of resources, FDI has been instrumental in contributing to Botswana's overriding long-term economic strategy directed towards rapid growth and economic diversification, "first beyond beef and later beyond diamonds". The first phase of diversification, from agriculture to mining, was very successful. The role of FDI in this phase was critical and was made possible by imaginative and well-crafted Government policies, that have attracted foreign investors over the long run.

The progress of the second phase of diversification has been uneven. The structure of output has changed visibly from mining towards services, owing to the rapid expansion of services industries in which foreign firms (notably financial services and tourism) as well as State-owned companies (infrastructure services) have played major roles. Although the absolute size of the manufacturing sector has increased in terms of both output and employment, this sector has not kept pace with the rapidly growing economy, and its share in total output declined slightly, to 4 per cent in 2000.²⁰ Except for the meat industry, foreign firms have been driving the growth of most other manufacturing

²⁰ However, this was due to stagnating meat production, which has not changed much since the 1970s. If meat-related manufacturing is excluded from the manufacturing sector, the remainder of the sector has done much better than total manufacturing.

industries. However, progress has been slow in the external sector, especially recently; this sector remains dependent on diamond exports to the same extent as it did 10 years ago, and alternative long-term sources of foreign exchange have not yet emerged. Yet FDI's contribution to non-diamond exports is also critical; except for beef exports, foreign firms are the main exporters of all other items such as soda ash, nickel and copper. While there are many local firms in a number of manufacturing industries, with shares in sales ranging from 20 to 50 per cent (except for meat where local firms are dominant), foreign firms are overwhelming contributors to exports, accounting for over 90 per cent of the exports of many industries. Also, the foreign segment of the tourism industry has been developed by foreign investors. All in all, without FDI, dependence on diamonds would most likely have been even greater.

Diversification of the external sector beyond diamonds remains Botswana's overriding objective and the greatest challenge to the Government, as the current high level of foreign exchange reserves can be expected to decline when the diamond boom ends (UNCTAD/UNDP, 2000: 52). The role of FDI in pursuing this objective will remain critical. While recent experience suggests that Botswana is not in critical need of foreign capital, it continues to need all the other components of the FDI package, including managerial, technical and professional skills, hard technologies and other (than skills) soft technologies such as software and access to (and information about) export markets. But, although FDI can help, it cannot go it alone. Development of the manufacturing sector, where foreign firms are key players, is instructive in this regard: it has failed to grow at rates contributing to the diversification of production and exports. Apparently the sector is facing limitations which, if not addressed, will impede future growth. Also, contributions of FDI to the local economy through linkages are not so much limited by strategies or choices of foreign firms as by the lack of local firms and capabilities which could interact with, or become suppliers to, foreign companies. Overall, the competitiveness of the economy seems to be a problem. Although FDI can contribute to enhancing this, it will not be and cannot be, the only force in this respect; policies aimed at building local capabilities and developing the domestic enterprise sector are equally, if not more, important.

II. THE INVESTMENT FRAMEWORK

Botswana has undoubtedly been successful in attracting FDI and managing it since independence. Arguably, it has balanced an open regime for FDI with giving due consideration to specific sensitivities of emerging local business interests. However, FDI policy is now undergoing a re-evaluation, which is unduly afflicted with doubts and caution. This is in obvious contrast with the growing liberalization of FDI regimes elsewhere in the world.

A. Specific FDI measures

I. Entry and establishment

Botswana has always been substantially open to foreign investment. It has never had a foreign investment law and relies on sectoral laws to implement policy on the entry of FDI. There is no foreign investment agency that screens foreign investors for approval to invest. Investor entry is promoted and facilitated by the Botswana Export Development and Investment Authority (BEDIA).

Since independence in 1966 some sectoral laws have been developed, some of which contain restrictions on FDI entry (see box II.1). FDI is not permitted in selected, mostly small-scale, businesses in retail trade services and manufacturing. These restrictions are intended to protect local entrepreneurs. FDI has not been restricted in areas that have grown strongly, such as mining, tourism, most manufacturing, and financial services. Indeed, much of the growth in these sectors is due to FDI. However, important utilities and services remain under State ownership and are not yet accessible to private investors – national or foreign.

This Review is being conducted at a time when Botswana's open FDI policy of the last 30 years is being debated. Almost 80 per cent of FDI is in large-scale mining, which has evidently been beyond the reach of national investors. Recent events in Botswana and abroad suggest that a more restrictive view is shaping policy as experience is gained with FDI in businesses judged to be more accessible to national investors.

First, Botswana's economic success has created a gap in living standards between that country and its neighbouring countries, leading to economic immigration, some of it purporting to be FDI.

Secondly, conventional wisdom has it that Botswana's open door policy and its generous incentives are prone to abuse by unscrupulous foreign investors, and thus that foreign investors must be more carefully screened in future. The demise of the Motor Company of Botswana is one of the main causes of this thinking, even though MCB did not enjoy the full range of incentives such as FAP grants or the concessional corporate tax rate for manufacturing (see box I.3)

Thirdly, a view is that small- and medium-scale FDI has reduced opportunities for national investors and helped to undermine local skills development (Government of Botswana, 1997:39).²¹ Unsurprisingly, this view coincides with a change in private sector development policy, from an entitlement to an empowerment approach, which aims to support national investors to become competitive and to grasp opportunities.

²¹ A 1997 Presidential Task Force exemplifies this approach: "There should be measures to attract foreign investment in a way that does not disempower local entrepreneurs", and, "There must be greater emphasis on producing local expertise rather than importing it"

Box II. 1. The business licensing system and the entry of FDI

Trading and other services

The Trade and Liquor Act established a licensing system for trading and services other than financial and professional services. The principal function of licensing is protection of the public. However the Act also empowers the Minister to reserve the granting of licences in any activity to citizens or 100 per cent nationally owned companies. Of the 19 types of licence, currently about 5 wholly or partly exclude foreign investors. These are principally retail trading, but also smaller restaurants and bars. The National Licensing Authority (NLA) and local licensing authorities administer the Act.

Manufacturing

Manufacturing requires a licence under the Industrial Development Act of 1988, amended in 1993 (currently being reviewed). Licensing is used in manufacturing to ensure that companies comply with environmental, health, planning and zoning requirements. The 1993 amendment to the Act abolished the requirement for applicants to demonstrate business viability, including their financial and technical capacity.

The National Industrial Licensing Authority (NILA) decides on applications for industrial licenses and may turn down applications for licenses that do not comply with the requirements stated above. However, the Act provides for appeals to be made to the Minister against decisions by NILA. The current Industrial Development Policy of 1997 recommends the repeal of exclusive licenses. This will be reflected in the revised Act. There are only a few small industries, such as manufacturing of school furniture, uniforms, protective clothing, burglar bars, sorghum milling, cement and baked bricks, and the baking of bread that are still reserved for citizens or companies that are wholly nationally owned. However, the Government has since relaxed the Reservation Policy to allow for joint ventures between citizens and foreign investors to manufacture products that have been reserved for citizens and medium-sized companies wholly-owned by citizens. Medium-sized enterprises are those with an investment range of between \$15 000 and \$400 000 in fixed assets, employing between 25 and 100 workers.

Tourism

All tourist-related businesses require a licence under the Tourism Act. The eligibility criteria are that the proposal must be in the interests of the tourist industry as a whole and of acceptable quality. The licence also incorporates a quality-grading scheme. There is no specific provision to reserve certain activities for national investment only, although trading licences (see above) would be required for many tourist-related businesses such as hotels, bars, restaurants and travel agents. Applications are decided by the Tourist Industry Licensing Board and its regional boards, whilst local authorities decide on restaurant applications.

Financial services

The licensing of banks, financial institutions and insurers is entirely prudential in nature and there are no FDI restrictions.

Mining

The regulatory regime for investment in mining is concerned with ensuring that investors undertake appropriate exploration and mining programmes in return for gaining exclusive mineral rights. There is no restriction on larger-scale mining projects of interest to foreign investors. Entry to small-scale mining is limited to citizens.

This debate has already had an impact in two respects: it has slowed down privatization and there are proposed new entry restrictions on smaller-scale FDI.

a. Privatization

Botswana has not moved in tune with the rest of the world in liberalizing key utilities sectors by introducing competition through privatization and new private investment; neither does it have legislation relating to public infrastructure concessions.

Electric power supply, fixed-line telecommunications, water supply and sewerage services, the airline, and the railways are all State monopolies. The Botswana Meat Commission, a State corporation, has a monopoly in the important processed-meat export sector, although this is to be reviewed. Half-hearted efforts have been made to open to private investment those industries that would be prime candidates for FDI. For example, a Telecommunications Authority was legislated in 1996 to regulate a potentially liberalized sector, yet fixed-line services remain a State monopoly; the granting of two cellular licences may be seen as sufficient competition to the Botswana Telecommunications Corporation. Also, an unsuccessful attempt was made to privatize Air Botswana.

A recent statement of privatization policy (Government of Botswana, 2000) tends to view foreign investors as investors of last resort in privatized enterprises. Chapter III discusses privatization and its role in FDI strategy.

b. Proposed foreign investment code

A foreign investment code has recently been proposed, which will prohibit any FDI in projects below a certain size. Thus a country, which, at independence adopted an open policy towards the entry of FDI and benefited greatly from it, is planning to impose certain restrictions. In contrast, most other countries adopted relatively restrictive FDI regimes at the outset of national independence and have on the whole liberalized those regimes since. Section D below evaluates the proposed new code.

2. Treatment and protection of FDI

Botswana's formal legal framework is not strongly developed in relation to standards of treatment and protection of specific interest to foreign investors. There is no foreign investment law and bilateral investment treaties (BITs) are in place with only four countries.²² Botswana therefore relies strongly on its past performance in its dealings with foreign investors. In that respect its track record is unimpeachable apart from a few exceptions from national treatment.

Botswana's standards of treatment and protection of foreign investors can be summarized as follows.

a. National treatment

In most facets of everyday business foreign investors are treated equally with national investors. The BITs accord the lesser standard of "fair and equitable" treatment to foreign investors. Exceptions from national treatment, driven by the wish to encourage local enterprise development include:

²² China, Germany, Malaysia and Switzerland.

- ◆ Thirty per cent of government construction contracts are reserved for citizens.
- ◆ No agricultural land can be transferred to non-citizens without ministerial approval. Non-citizens include companies that are majority foreign-owned. The wish of a citizen to acquire such land can be one of the grounds for rejecting the transaction. Ministerial approval is also required for foreign investors, but not national investors, to enter into arrangements to put tribal land to commercial use.
- ◆ All financial incentive schemes – such as the Credit Guarantee Scheme and a loan fund for citizen contractors – are closed to foreign investors. The FAP, which used to be open to foreign investors in medium and large-scale projects, is to be replaced with subsidized loans, which will not be available to foreign investors. A proposed venture capital fund will be open to foreign investors, but is not expected to offer concessional terms.

b. Non-discrimination

Are foreign investors protected from discriminatory treatment based on their home country? Apart from standard most-favoured-nation clauses in the BITs, there is no legal provision in Botswana for equal treatment of foreign investors, irrespective of their home country. There are no known instances of departure from the principle, except for the standard exclusion for double tax treaties. It does not appear that Botswana's membership of various regional agreements has led to preferential treatment of investors from regional countries.

c. Repatriation and convertibility

Botswana does not impose restrictions on the transfer of profits or proceeds of disinvestments. And no foreign investor has been unable to make such transfers from Botswana for any reason including convertibility of the pula. Botswana has now abolished foreign exchange controls. Of course investors, other than those covered by BITs, cannot be sure that exchange restrictions will never be re-established thereby affecting their ability to access dividends and disinvestments proceeds. Botswana should be prepared to negotiate BITs with suitable provisions with home countries for those investors that require reassurance that they will not suffer in any future reversal of Botswana's policy.²³

The existing BITs provide for wide, and usually unconditional, rights of repatriation, including not only disinvestments proceeds and profits, but also fees, royalties and debt service.

d. Expropriation

The Constitution provides that expropriation can only occur for the usual sorts of public policy reasons and only if an enabling law is enacted to provide for prompt and adequate compensation. Where compensation is to be remitted overseas there may be "reasonable" restrictions on the manner of such remittance. There is right of appeal to the High Court for all these provisions.

A specific right is reserved to expropriate mineral interests, to secure their development, and to pay compensation in the form of recurring royalties rather than a lump sum. This reserve power has been balanced in the new Minerals Act by providing for retention rights. So far, Botswana has never expropriated a foreign investment.

²³ Such a reversal is highly unlikely for many years, for a number of reasons, including the protection against it that is provided by Botswana's large foreign exchange reserves.

e. Dispute settlement

Foreign investors have full and equal recourse to Botswana courts, which are regarded as fair and impartial (see section B.7). It is understood that Botswana may grant the right of international arbitration to settle a dispute arising from its agreement with a foreign investor. However, the State enters into relatively few agreements with investors and none were reviewed. For example, the recently amended mining law does not entitle investors to negotiate contractual rights in respect of licence terms and the mine development programme, except for diamond-mining investors. Such rights are now the international norm in that industry.

f. International agreements

The four BITs contracted by Botswana provide for international arbitration, typically by reference to the Convention on Settlement of Investment Disputes between States and the Nationals of Other States, to which Botswana has acceded. Botswana ratified the application of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards in 1971 and is a member of the Multilateral Investment Guarantee Agency (MIGA).

Extension of the BIT network is desirable; it should be guided by two principles:

- ◆ It should be *proactive* in supporting specific initiatives to attract FDI. The most obvious initiative is the International Financial Services Centre (IFSC). An expanded BIT network with neighbouring countries would support this initiative if the BITs were to contain extensive funds' repatriation provisions. In this respect Botswana would view itself as a potential home country and not in the traditional host country role; and
- ◆ Otherwise it should be *reactive* by relying on requests from governments whose investors place great importance on having BITs in place. This is likely to be the case from Asian countries, which are increasing sources of outward FDI. This sparing approach should ensure that once a request is made, there is capacity to respond with impressive speed. To this end, UNCTAD's forum for BIT negotiations could be utilized.

In concluding, the absence of a foreign investment law or an extensive BIT network have not hindered FDI because Botswana has established good practices. Other things being equal, a foreign investment law is not necessary in Botswana. However, the review of the proposed foreign investment code (see Section D below) suggests that there may be some advantages now in codifying good investor treatment principles.

B. General investment measures and conditions

This section reviews those areas of the policy and operational framework that affect all investors and form part of the investment climate that has an impact on FDI. Many aspects of operating conditions in Botswana are of high quality. Overall, the financial and corporate areas are of a good standard, but some basic regulatory areas are not. Most attention is given here to those areas that are problematical for investors. Table II.1 provides a snapshot of the assessment of general standards.

Table II. I. Guide to the assessment of operating conditions

SECTION	HIGH STANDARD	MEDIUM STANDARD	LOW STANDARD
B.1	Foreign exchange		
B.2		Taxation	
B.3	Employment		
B.4			Non-citizen employment
B.5			Land
B.6			Competition policy
B.7	Rule of law		
B.8		Intellectual property protection	
B.9	Corporate standards		
B.10		Licensing	

1. Foreign exchange control

Over the 1990s Botswana progressively eliminated foreign exchange controls. By February 1999 all foreign exchange controls were abolished. The exchange rate is actively managed to maintain a stable relationship with the South African rand. South Africa has inflationary pressures and these are therefore transmitted to Botswana through its high import dependence on South Africa. Nevertheless, inflation (6 to 8 per cent in recent years) is moderate and manageable.

Botswana has a long history of convertibility and faces the prospect of continued sound economic management as evidenced by its award last year of investment grade status by the international credit rating agencies. Also it is likely that major investors – such as in mining or in privatized industries – could negotiate contractual assurances of bankable foreign exchange arrangements on a project-by-project basis.

2. Taxation

Botswana business is subject to a two-tier income tax system comprising of 15 per cent basic company tax and 10 per cent additional company tax. Dividend withholding tax (which is 15 per cent for residents and non-residents) can be credited against additional company tax. This attractive feature of business taxation in Botswana leads to: (a) a moderate rate of tax on distributed earnings (a maximum of 27.75 per cent on fully distributed earnings), and (b) near neutrality between distribution and retention of earnings for reinvestment (earnings with nil distribution are taxed at 25 per cent). However, annual capital allowances are modest, ranging from 2.5 per cent for buildings to 10-15 per cent for office equipment and furnishing, and 15- 25 per cent for industrial plants and equipment. Industrial buildings qualify for an accelerated 25 per cent initial allowance in the first year. A usual range of deductions is allowed with adequate provisions to limit transfer pricing. Losses may be carried forward five years.

Manufacturing and the new International Financial Services Centre (IFSC) have concessional income tax rates. A special regime has been developed for the mining sector. These variations are reviewed in section C 4 below. There are also potential tax deductions for expenditure on vocational training of full-time citizen employees, and on training programmes approved by the Commissioner of Taxes.

Withholding taxes apply on payments to non-residents of interest, royalties and fees. Botswana has signed only four double taxation treaties (DTTs),²⁴ and they give no relief except for marginal reductions (of 12 to 12.5 per cent) in the treaty with Mauritius. Withholding rates on interest are a strong disincentive to investments requiring substantial third-party debt. It seems improbable that Botswana has been able to impose 15 per cent withholding tax on payments of interest on debt to fund major projects such as mining developments. The Commissioner of Income Taxes is allowed some discretion to reduce interest on withholding tax, but a less onerous universal policy, with proper safeguards against thin capitalisation, needs to be developed.²⁵

Three of the BITs have tax sparing provisions. The exception is the treaty with South Africa. Negotiations for treaties are underway with France and Zimbabwe, whilst Germany and the United States are reported to have shown little interest.

The top marginal tax rate on individuals is 25 per cent.²⁶ Value-added tax at the rate of 10 per cent is to be introduced from mid-2002 to replace sales tax.

As part of the Southern African Customs Union (SACU) Botswana is bound by common external tariffs on imports. The import tariff policy is dominated by South Africa, which, historically, has used tariffs to promote domestic industry. In recent years, the average level of the common external tariff of SACU has been sharply reduced because of South Africa's membership of the WTO. Tariffs range up to 10 per cent on industrial raw materials, up to 30 per cent on industrial plant and equipment and up to 45 per cent on basic consumer goods. Botswana has the right to levy additional duty but does not currently do so. In 1998 the WTO calculated that the weighted external tariff was 15.1 per cent with wide dispersion; 44 per cent of tariff lines are duty free (World Trade Organization, 1999). Also, imports from the EU will soon be duty free under a new treaty, although the impact on industry in Botswana will not be as great as might be expected, according to a study by the Botswana Institute of Development Policy Analysis (BIDPA).

²⁴ With South Africa (1978), Sweden (1992), Mauritius (1995) and the United Kingdom (1997).

²⁵ It has been noted that Botswana is wary of offering preferential treatment to loans sourced internationally for fear of deterring investors from borrowing domestically, especially given that domestic financial institutions have excess capital.

²⁶ The rate had deliberately been set at the same level as that for company taxation to avoid incentives to incorporate as a way of reducing tax.

3. Employment

Botswana has good industrial relations; investors are quick to compare the country favourably with South Africa and it is a factor in investment relocation. Labour law is regarded as being up to international standards and Botswana adheres to conventions of the International Labour Organization (ILO). Workers may organize unions but there is little unionization of the workforce and little collective bargaining or organized work stoppage. There are no major rigidities in hiring and firing, although there are some minor anachronistic provisions.²⁷

Wage rates are a potential issue at both unskilled and skilled levels for different reasons.

There is a statutory minimum wage for the retail trades, and the Minister for Labour can set minimum wages for categories of employees in other business sectors under the Employment Act. The Minister acts with the advice of a Minimum Wages Advisory Board (on which there is equal representation of employers, employees, the Government and independent members), but is not bound to follow its advice. The Board must consider employee welfare and wider questions of employment and economic growth.

Currently, minimum wages are set for the building industry, car service and distributors, road transport, the hospitality and entertainment industry and manufacturing, as well as wholesale and retail trade (i.e. about one third of business activity). There is only one minimum wage in each sector apart from a lower minimum for security guards.

Employers interviewed did not see the minimum wage (currently equivalent to about \$0.40 per hour) as an impediment, although interviews with established investors will necessarily excluded those who might have been deterred by high minimum wages. Interviewees noted that wages paid are lower than in South Africa, but stated that labour productivity is also lower.

Determination of the minimum wage must give due attention to the economic impact. Real minimum wages in manufacturing have fallen nearly 20 per cent over the last decade.

Wage rates for semi-skilled and skilled workers are considered by investors to be high. This could reflect several factors: scarcity of skilled citizens, competition from the Government, which pays well, and low tolerance of imported workers. The scarcity of technical skills and business-related skills may be due to a lopsided training strategy, which, since independence, has given emphasis to developing domestic capabilities for the public sector. For example, Botswana still has only 40 citizens who are chartered accountants (which, nevertheless, represents a considerable improvement over the last 15 years), and the engineering faculty at the University of Botswana was established only in 1995.

A resource boom creates strong upward pressure on public sector wages. How has the Botswana Government done in restraining public sector wages from pricing out the private sector for skilled people? Table II.2 compares government wages with per capita income in Botswana with other groups of countries. The right hand column suggests that Botswana has done well in restraining public sector wages, especially in comparison with the rest of Africa. However, the high proportion of wages to GDP (middle column) may be an indicator of a large base of low-paid employees, which reduces the average wage as a multiple of GDP per capita. Top civil service salaries and benefits are at least 10 times GDP per capita.

²⁷ For example, a requirement to obtain government permission to relocate a citizen employee overseas.

Table II. 2. Public sector wages ^a

COUNTRY/REGION	CENTRAL GOVERNMENT WAGES AS PER CENT OF GDP	AVERAGE CENTRAL GOVERNMENT WAGE .. AS MULTIPLE OF PER CAPITA GDP
Botswana	11.5	2.2
Africa	6.7	5.7
Asia	4.7	3.0
OECD	4.5	1.6

Sources: Schiavo-Campo, de Tommaso and Mukherjee, *An International Statistical Survey of Government Employment and Wages* (World Bank) for regional data. UNCTAD estimates for Botswana.

^a 1999/2000 for Botswana and various years during the 1990s for other countries.

4. Employment of non-citizens

It was widely stated in interviews that Botswana is suffering from a scarcity of skilled workers in the private sector. Surveys confirm this impression. For example the Africa Competitiveness survey ranks Botswana 20th out of 24 African countries in availability of educated workers – the lowest ranking Botswana achieved on any of the investment climate indicators (World Economic Forum, 2001). However, investors' needs to recruit non-citizen staff to fill skills gaps are frustrated by inappropriate policy and administrative bottlenecks. All non-citizen employees and self-employed persons are required to have work and residence permits. Separate acts govern employment of non-citizens and immigrants. In practice, the labour and immigration authorities evaluate applications jointly through regional immigrant selection boards. A national board acts as an appeals tribunal and most of its decisions are subject to further appeal to the Minister.

Work permits for employees are only granted on the basis of:

- ◆ A labour market test (i.e. that there are no suitable national candidates, although the precise condition is worded more enigmatically in the legislation); and
- ◆ Submission by the employer of a satisfactory programme to train a citizen replacement for each position. An applicant's qualifications are also considered, although there is no explicit legal basis for this assessment.

Work permits for self-employed non-citizens have the same labour market test but, obviously, without training and localization conditions attached. Work and residence permits are granted for 3-5 years and may be subject to renewal on the same conditions.

Some foreign investors interviewed believed that the localization requirement is implemented too rigidly and without regard to sound commercial requirements for employing non-citizen staff. Many interviewees were unhappy with the substantial delays in the processing of applications. Many non-citizen employees remain in post under a procedure of waivers that must be renewed every three months. One investor claimed that some individuals had remained in waiver status for years. Nevertheless, there is a feeling in some government circles that labour market tests are not exacting enough, given the citizen-empowerment objectives of Vision 2016. The Government

acknowledges that there are delays in the processing of work permits and is investigating computerization, increasing penalties and contracting out certain services (Government of Botswana, 2000 c). The Department of Labour and Social Security does not publish data on its handling of applications.

The work and residence permit policy is complicated by the substantial economic migration to Botswana from neighbouring countries experiencing hardship. The Department of Immigration regularly deports illegal migrants, but would not confirm the numbers estimated to be in Botswana. Unofficial estimates suggest over 100 000. Many officials believe that economic migrants obtain work and residence permits by purporting to be investors and that the licence approvals system (see box II.1) is not sufficiently rigorous.

These two issues – pressure for further localization of the workforce and pressures of economic migration – have become unduly linked in official attitudes. There is a feeling that foreign investment has become a channel for legitimizing economic migration.

It is recommended that policy on the issue of work and residence permits be reviewed. In the absence of information on the total number of permit applications it is difficult to know whether the machinery should also be overhauled. However, on the basis of the total of around 14 000 issued work permits of 3-5 years duration, the number to be handled per year does not seem an undue administrative burden. There appears to be no policy statement that balances the need for imported skills and the reasonable requirements that Botswana nationals be given training and opportunities for advancement. There is an unwritten lore which:

- ◆ is not cognizant of international experience; and
- ◆ does not give due recognition to the speed at which the Botswana economy is growing and changing, and the gaps in skills training and work experience in the private sector.

However, statistical evidence shows that Botswana is not unduly reliant on foreign workers at the expense of citizens. Table II.3 below compares the experience of Botswana with that of the OECD countries. The most useful comparison is with those countries that record foreign workers by place of birth, rather than citizenship, as Botswana citizenship is comparatively difficult to obtain. Australia, Canada and the United States have far higher proportions of foreign-born workers in the labour force than does Botswana in its work force²⁸. A number of other major OECD countries have similar proportions of non-citizens in their labour force, even though many foreign-born workers are likely to have been granted citizenship. Moreover, in most of these economies the foreign participation ratios are increasing.

²⁸The comparisons are not exact because Botswana data is for the workforce, not the labour force. In addition, there is considered to be substantial disguised unemployment.

Table II. 3. Labour force localization rates

COUNTRY/REGION	FOREIGN LABOUR AS PER CENT OF TOTAL LABOUR FORCE
Botswana	5.1
OECD countries recording foreign-born workers:	
Australia;	24.8
Canada;	19.2
United States.	11.7
Other OECD countries:	
Austria, Belgium, France, Germany, Sweden;	More than 5 per cent
Denmark, Ireland, Italy, Japan, Netherlands, Norway, Portugal, Spain, United Kingdom.	Less than 5 per cent

Sources: OECD (2001), OECD in Figures (OECD data for various years during 1995-1998); Central Statistical Office of Botswana.
a Only three OECD countries record the birthplace of foreign workers. Other OECD countries record citizenship.

Furthermore, given that Botswana has undergone a remarkable economic transformation in less than 30 years, there are bound to be gaps in skills and experience of the workforce. Investors interviewed suggest that there are still gaps in managerial, professional and technical skills for business, despite the new priority that has been given to vocational training over the last 20 years. It has been suggested that Botswana continues to concentrate its advanced education and training on academic and social science subjects suitable more for public sector localization than for the needs of the private sector.

This is not solely an FDI issue or even a private sector issue. There is some evidence that workforce localization rates are as high in the private sector as in the public sector. National investors also have normal business requirements for non-citizen staff; among firms interviewed for this Review, a nationally owned firm employed the highest ratio of non-citizen to citizen employees.

Some developing countries no longer utilize formal labour market tests nor impose training and localization programmes. They rely more on the natural incentives of investors to avoid recruitment of costly expatriate workers by establishing their own training programmes and local recruitment policies. Other countries adopt a yardstick that permits foreign workers who earn a specified multiple of the average wage. This would probably not suit Botswana, which has a concern that family-run businesses are importing workers who are relatively unskilled. Nevertheless, the reality is that much foreign investment in Botswana in such sectors as tourism, manufacturing and services will be from small and medium-scale sources, such as privately held family businesses, and not giant transnational corporations. Such businesses will often be more comfortable with family members and associates in key positions.

A new approach to non-citizen employment is required. It is recommended that the Government consider developing a 5+5+5 policy as follows:

- ◆ A key worker scheme should be introduced for all investments over a given size. Each such investment would automatically entitle the employer to have five key positions available for non-citizen employment for the duration of the investment. These positions would not require a labour market test. Training and localization would not be obligatory and would depend on the natural commercial incentives of the investor. Malaysia, the Philippines and Singapore, among others, have such schemes. This facility would be available for both employees and self-employed investors.
- ◆ Additional managerial, supervisory and technical posts should be available for non citizen recruitment on a more flexible basis. For investments over a given size, new investors in any industry, and all investors in priority sectors, another five posts should be available without a labour market test and a training and localization programme, provided that,
 - Such posts pay, say, twice the average wage as confirmed by tax returns, or are designated as occupations in which there is a national shortage of skills; and
 - The investor agrees to submit a training and localization programme after the first five years of establishment in order to retain any of these posts for continued non-citizen recruitment.
- ◆ Work and residence permits should be issued for up to five years, depending on the duration of the employment contract;
- ◆ For new investors, these arrangements should be subject to post-investment audit to confirm that the proposed investment has taken place, as recommended in section 5 on the proposed Foreign Investment Code.

Benefits of this new approach would include:

- ◆ Lower barriers to entry for new investors in established industries and less pressure to poach trained staff from competitors;
- ◆ Certainty for investor/managers of continuing active involvement with the business (this principle is already implicit in the Non-citizen Employment Act);
- ◆ Enabling both the authorities and the new investor to develop a training and localization plan after some years of actual experience; and
- ◆ Accommodating investors who need the assurance of long-term stability of involvement of family members and associates.

More generally, the need for rapid recruitment procedures has been magnified by the skills shortages created by the HIV/AIDS problem²⁹.

²⁹ According to a study by BIDPA, the adverse impact of HIV/AIDS on living standards can be limited if skilled workers affected by HIV/AIDS, who can no longer work, can be quickly replaced (BIDPA, 2001).

5. Land

Land is owned as tribal land, State land or freehold land. Tribal and State lands can be brought into commercial use through the granting of leases and use-permits or by conversion to freehold. Statutory land boards manage the allocation of tribal land, formerly the prerogative of tribal chiefs. It appears that where tribal land is put to commercial use, it is usually under short-term leases or permits (less than 10 years) and is not a bankable title. State land can be converted to long-term leasehold or freehold title that can be registered and pledged. The President has delegated to the Department of Lands the authority to grant private title to State land, although there seem to be no guidelines in the State Land Act to govern the procedure.

The acquisition of land by foreign investors is subject to explicit ministerial approval in respect of:

- ◆ Use of tribal land;
- ◆ Acquisition of State land. The Land Control Act requires ministerial approval for any dealings in agricultural land with non-citizens.

Botswana's fast growing economy is bound to put pressure on the land allocation system. Unsurprisingly the main pressure point is the conversion of agricultural land to commercial and industrial use and ownership. This seems to be most acute in Gaborone, which is expanding into its agricultural hinterland. Investors see the bottlenecks as:

- ◆ Exceptionally slow re-zoning of land for alternative uses and of planning permission for development;
- ◆ Slow ministerial approval, where needed, and slow registration of land titles. The Department of Lands conceded that there were some delays but was unable to provide statistics on the problem.

Beyond these administrative issues, it is difficult for this Review to determine if there is a systemic issue in deployment of land to new uses as the economy grows and diversifies. Government authorities appear to be taking a leading role in the development of serviced sites that are then allocated on non-market terms. Other government agencies, such as the Botswana Export Development and Investment Authority (BEDIA) and the Botswana Development Corporation, are constructing factory shells for their clients. This activity is portrayed as a proactive government effort to provide land for investors. Yet commercial development of this kind should be undertaken by the private sector. Several interviewees believe that a clique of national investors has established a monopoly on Gaborone land for speculative purposes. A shortage of land has even extended to sites for executive residential development. If so, this should be tackled by a competition authority when established.

The Review highlights the following issues for the Government to address in the interests of improving the investment climate:

- ◆ Re-zoning policy and practice;
- ◆ A land allocation approvals system;
- ◆ Development of a freer market in land with more private sector involvement in site development and commercial construction; and
- ◆ Publication and analysis of performance data by the Department of Lands.

6. Competition policy

Botswana has no competition law. A competition policy is being prepared, which is expected to lead to a competition law and the creation of an enforcement agency. It is not clear how active the Government will be in implementing such a law. There is a widespread view that the entrenched local business elite will not favour competition, especially that from new FDI. The only example offered in Government interviews of undue market concentration was a recent case of the proposed merger of two foreign-owned wholesalers. Although consumer protection legislation was enacted in 1998, it is not designed to reduce barriers to entry of new investors.

On the other hand the Government is not sufficiently conscious of the importance of a well-enforced competition law for ensuring against powerful investors (often likely to be foreign investors) becoming dominant and abusing market power to the detriment of consumers and industrial customers. For example, there is some dissatisfaction with the cost and speed of basic banking services. This opens the door for recent entrants in commercial and merchant banking to seize the resulting opportunities, and there is evidence that this is happening.

Competition policy, to be effective, should be implemented in cooperation with South Africa, and possibly the rest of SADC. There are examples of South African firms setting up marketing or distribution companies in Botswana, charging much higher prices than in South Africa, and making it impossible for importers in Botswana to import directly. This can only be tackled in conjunction with a South African/SADC-wide competition policy.

The Government itself has extensive monopoly interests in various State enterprises, and privatization has been slow. Air Botswana provides a good example. It has a statutory monopoly on main domestic routes; it may allow private operators on particular routes, but in the view of a private sector organization it can withdraw the operating concession if a route proves to be profitable. Ironically, its privatization and associated opening of the market to competition has been frustrated by, among other things, a Government desire to place the industry under price control to protect the consumer.

7. Rule of law and respect for property rights

Interviews and independent surveys confirm that Botswana has high standards of adherence to the rule of law, respect for contract and protection of property rights. The judicial system is regarded as fair and competent and court judgements are enforced. Administrative corruption is low – no doubt due in part to adequate government salaries and to the importance placed on anti-corruption enforcement by the authorities. Botswana has specific anti-corruption legislation, a dedicated enforcement unit and significant criminal penalties for acts of corruption.

8. Intellectual property protection

A full complement of legislation to protect intellectual property rights was completed in 2000 with the passage of the Copyright and Neighbouring Rights Act. Copyright registration will now be available to investors, along with protection of patents and designs from earlier legislation. There have been breaches of music copyright, but there are no serious breaches of intellectual property rights that would affect domestic investors.

9. Corporate governance and accounting standards

The Companies Act is being thoroughly modernized in consultation with the private sector to take account of latest international practice. If adopted, the proposed reforms will, among other things, simplify registration, bring greater clarity to the duties of directors, and require that all accounts for listed companies, or companies where there is significant public interest (for example, unlisted companies that provide essential services to the community, or are major employers), be prepared in accordance with international accounting standards. SMEs may require a different set of standards that are consistent with their accounting and reporting needs.

10. Licensing and the administration of regulations

The extent of sector-level licensing can be gauged from box II.1. The scope seems appropriate, except for industrial (manufacturing) licensing. There is no public interest reason for licensing this sector; given that there are mechanisms elsewhere to regulate health and safety, consumer protection and environmental protection. In part, the industrial licensing system is used to screen FDI out of reserved activities. There is no good reason for the Government to oblige all applicants to apply for an unnecessary licence in order to implement its policy governing a handful of industries. This point is better appreciated when taking into account the number of licences and permits needed by a business: according to the industry association, a tourist business, for example, may require up to 46 different kinds of permits. Some of these could clearly be eliminated or consolidated.

Delays and duplication in licensing are frustrating for investors, but on the whole the process is predictable and transparent. However, there are difficulties: some areas of licensing and registration are facing severe bottlenecks and, if not rectified, will damage the investment climate. The following are some of the main problem areas:

- ◆ The issue of work and residence permits is slow and inefficient (see section B.4 above);
- ◆ Re-zoning of land for commercial or industrial use appears to be slow (see section B.5 above); and
- ◆ Registration of interests in land titles is extremely slow, according to several interviewees. The business of one foreign investor interviewed is suffering directly as a result.

C. Sectoral investment incentives and related initiatives

I. Introduction

Table II.4 outlines the sectoral profile of significant investment incentives and related initiatives that affect FDI. The FAP scheme is reviewed in sub-section 2 below, followed by a review of measures in key sectors.

Table II.4. Investment incentives available for FDI

SECTOR	RECENT CHANGES	KEY CURRENT INCENTIVES
Manufacturing	FAP abolished (2000)	15 per cent profits tax under a Development Approval Order
Mining	Reform of legal and fiscal regime (1998-1999)	Special tax and royalty regime. See box II.2
Tourism	FAP abolished (2000)	None
Financial services	Establishment of an International Financial Services Centre (2000)	15 per cent profits tax and withholdings relief. See box II.3
Utilities	Privatization policy	Privatization moribund
All sectors	Foreign investment support project abolished	Case-by-case tax relief under Development Approval Orders and tax agreements

The Financial Assistance Policy (FAP) has been the pre-eminent incentive scheme of the last two decades. Its demise means an overall reduction in financial incentives for investors, and especially foreign investors, who will not participate in a successor scheme. It will be argued that while a logical framework for incentives is developing, it lacks the boldness inherent in the FAP. The fallout from the severe criticism of the FAP scheme may have reinforced this more cautionary approach.

2. Financial Assistance Policy

The FAP offered financial grants to encourage investment and employment in non-traditional sectors. Initially the scheme focused on manufacturing and non-traditional agriculture, but expanded over the years to include tourism, small-scale mining and related service businesses. Grants were linked to projected employment of skilled and unskilled Botswana labour (the capital grant) and to wages paid to them (the wage subsidy). For medium and large-scale projects, the grants were available to both foreign and national investors although the capital grant – essentially an establishment grant – was higher for national investors. The wage subsidy was generous, starting at 80 per cent of the wages bill for unskilled labour in the first year and tapering off to 20 per cent in the fifth and final year.

The FAP was abolished for new applications in 2000, following a highly critical evaluation of its rationale, effectiveness and administration (Botswana Institute for Policy Analysis, 2000). The extent of abuse and, in some cases, fraud, was a major influence on subsequent government thinking on FDI.

It is difficult to disagree with the evaluation of the FAP, but its impact on FDI policy has been exaggerated and incorrect lessons have been drawn.

- ◆ Fewer than 40 per cent of medium and large-scale projects receiving grants were either 100 per cent foreign-owned or joint ventures. Moreover, there is no evidence that foreign investments led to more abuse and fraud than national investments. In fact, a greater proportion of beneficiaries abused the small-scale FAP programme, from which foreign investors were excluded. Foreign investors were involved in some high profile cases which had mustered strong official support and were embarrassing to the Government;
- ◆ The FAP scheme was extraordinarily generous (see average grant size in table II.5) and was bound to attract some unscrupulous investors. Evaluation procedures failed to identify them all. Ironically, the FAP evaluation found little evidence that the FAP grants were a crucial factor in attracting to Botswana those foreign investors who came and have remained. UNCTAD's interviews are consistent with this, although one investor found the scheme to be very helpful in providing working capital during a period of rapid growth.
- ◆ The Government is now concerned with identifying "genuine" foreign investors in all industries. As a universal principle, this is misdirected (see section 4).

Table II. 5. Financial Assistance Policy grants

	MEDIUM-SCALE PROJECTS (1982-1999)	LARGE-SCALE PROJECTS (1988-1999)	
Average grant (\$'000)	Agriculture	104	439
	Industry	233	1 986
	Mining	789	955
	Tourism	60	326
	All	195	1 761
	Total committed (\$ m)	147	148
	Total number approved	751	84

Source: Botswana Institute for Policy Analysis, Financial Assistance Policy, 2000
 a All values are pula totals in 1999 constant prices converted at \$/pula 1999 average exchange rate.

The axe on the FAP scheme has fallen disproportionately on FDI. FAP is to be replaced by various financial and technical support programmes to be administered by a new body: the Citizen Entrepreneurial Development Agency (CEDA). Grants will be replaced by concessional loans (up to a limit equivalent of about \$350 000) and credit guarantees, but these will not be available to foreign investors. Foreign investors can seek funding from a Venture Capital Fund to be established, but it is understood that this will provide funding on market terms.

For all its faults in execution the FAP scheme had one strong virtue. It was bold. It attempted to leverage Botswana's key strength - diamond revenues – by committing nearly \$300m (in 1999 prices) of budgetary funds in a great leap forward towards rapid economic transformation. It is now apparent that more fundamental issues had to be addressed for development and diversification of the private sector – education, training and on-the-job development of industrial disciplines and skills, experienced management, and inculcation of entrepreneurship. Perhaps it should also be emphasized that incentives are not a primary factor in attracting FDI.

3. Tax agreements and development approval orders

The Minister of Finance may, with Parliamentary approval, provide income tax concessions by a development approval order or by tax agreement. The concessions can take the form of reduced rates of tax on profits or withholdings or more favourable treatment of expense deductions.

These incentives are granted on a case-by-case basis, although there is a relatively well-defined process for reducing corporate tax for manufacturing to 15 per cent (see section 4.a below). Since 1996, a total of 79 development approval orders have been issued, almost all of which have related to manufacturing. Four tax agreements have been entered into: three for mining, including the diamond industry, and one for telecommunications.

4. Sectoral initiatives

Two initiatives were recently established at the sectoral level to accelerate private investment. These are the modernization of the legal and fiscal regime for mining and the creation of the International Financial Services Centre (IFSC). Both initiatives build on the comparative strengths of Botswana and are strategically well conceived. But they are not aggressive. Changes have also taken place in the incentives system in manufacturing and there is potential for further investment incentives in tourism and utilities.

a. Mining

The mining sector reforms (as summarized in box II.2) aim to increase investment in exploration and mining of precious and base metals. The fiscal regime specifically addresses minerals other than diamonds. The reforms were undertaken professionally with due attention to conditions offered in competitor countries. It appears that Botswana deliberately chose not to offer a highly competitive fiscal regime. Caution is evident in the following provisions:

- ◆ Relatively high rates of mineral royalty;
- ◆ Right of the State to acquire up to 15 per cent equity without being exposed to exploration risk;
- ◆ Restricted loss carry-forward provisions for exploration;
- ◆ Upward sliding-scale income tax; and
- ◆ High and non-negotiable rate of interest on withholding tax, despite new controls on thin capitalization.

In other respects as well, Botswana has judged that its good track record of investor treatment does not warrant the provision of investment terms which are increasingly the norm elsewhere. The new law does not grant an investor (apart from a diamond miner) the right to enter into an agreement with the State over licence terms, including the mining development programme, or to stabilize the fiscal and foreign exchange provisions.

This middle-of-the-road approach has not yet paid off. The Department of Mines does not publish information on licence grants and expenditure for exploration, but acknowledges that there has not been a pick-up in exploration activity since the new legal and fiscal regimes were introduced. This contrasts with the strong growth in much more aggressive reformers such as the United Republic of Tanzania.

Box II. 2. Modernization of the mining sector regime

Botswana is a leading world producer of diamonds from open-pit kimberlite mines. It also produces nickel, copper and cobalt in matte (from both underground and open-pit mining operations), soda ash and coal which is mainly used for domestic power generation and heat-raising processes at the mines. Most mines are owned and operated by joint-venture companies, in which the State has significant financial participation in partnership with foreign private investors.

The fiscal regime for diamond mining is subject to case-by-case negotiation of key provisions, including taxation and Government participation. This is a logical approach because each diamond deposit is unique, and because diamond mining and marketing are fundamental to the national economic strategy. In addition to taxation, the State has frequently taken a 50 per cent equity share on concessional terms in the existing mines, in particular in the major diamond mines.

A legislated fiscal regime applies to non-diamond mining. It was reformed in 1998 in order to encourage additional private investment in exploration and production of other minerals. Companion reform of the legal regime for mining was implemented in December 1999 in order to give greater clarity and security to holders of mineral rights. Botswana's international reputation as a highly successful and reliable location for investment in diamond mining had not carried over to strong investment activity targeted at other minerals.

Key elements of the new fiscal regime for producing mines include:

- ◆ Royalty of 5 per cent on the sales value on precious metals and of 3 per cent on other minerals;
- ◆ Immediate depreciation of mining capital expenditure;
- ◆ Indefinite loss carry-forward; pre-development exploration expenditure booked to profit and loss when incurred, and losses arising can be carried forward, but for no more than five years;
- ◆ A sliding-scale rate of income tax, starting at 25 per cent and rising as the ratio of taxable income to gross income exceeds one third;
- ◆ The State may purchase up to 15 per cent equity interest on market terms at development approval stage;
- ◆ Standard rates of 15 per cent withholding tax are imposed on interest, dividends and service fees;
- ◆ Almost all mining capital items and consumables are imported and import duties are governed by SACU tariffs;
- ◆ Under the new arrangements, taxation may not be varied by agreement, but the Minister has power to remit or defer royalty.

b. International Financial Services Centre

Key features of the International Financial Services Centre initiative are described in box II.3. The concept is strategically sound and the fiscal provisions seem appropriately designed for these activities to be competitive (e.g. with Mauritius). The initiative has been rewarded with immediate interest from foreign investors. It could be pursued more vigorously by breaking down unnecessary barriers to dealing by IFSC companies with residents. For example, Botswana has high national savings and financial liquidity in relation to domestic investment and financing opportunities. IFSC companies can raise equity capital in Botswana (including on the stock exchange) but they may not borrow from the domestic public. If so, this could be relaxed in the case of offshore banking units. They should be encouraged to become vehicles for regional trade and investment financing – thus combining their skills with Botswana's financial strengths.

Box II. 3. International Financial Services Centre

The IFSC, approved in 1999, provides fiscal incentives for offshore financial services provided from Botswana. Approved investors must have substantive operations in Botswana and provide employment and skills development, unlike pure holding company operations. The financing of transactions and associated services may be conducted only with non-residents and in foreign currency.

Botswana's strong public finances, absence of foreign exchange controls and orderly business climate are important attractions to companies wishing to use Botswana as a base for regional operations. These attractions are supported by a concessional, single-tier corporate profit tax of 15 per cent (which is stabilized until 2020), a unilateral credit for taxes paid on income earned abroad, and no withholding taxes in Botswana on payments of dividends, fees, royalties and interest to non-residents. The Government is also considering allowing a double deduction for income tax of rental payments for offices constructed for the IFSC.

So far eight investments have been approved. These include two leading Zimbabwean companies – one finances its agricultural seeds' supply business in nearby countries from the IFSC and the other utilizes it as a platform to extend its investment banking business in the region. In addition, Barclays, the United Kingdom bank, has set up a credit processing operation for its African operations.

IFSC investment facilitation is handled by the Botswana Development Corporation under contract to the Government.

Source: UNCTAD mission.

c. Reduced incentives: manufacturing

Manufacturing has a lower corporate tax rate than other sectors. The basic company tax rate for manufacturing is 5 per cent (compared with 15 per cent in other sectors), and the additional company tax rate is 10 per cent. Thus tax paid is 15.0 – 19.25 per cent of earnings, depending on the level of dividend distribution. Access to this concession is by application, but in 1996 access was made relatively automatic for “manufacturing” which is defined to exclude assembly, packaging and other low-value added operations (Manufacturing Development Approval Order, 1996). There are no special incentives in relation to treatment for expenses and capital allowances.

Concessional profits tax treatment plus availability of FAP grants were a potent combination in presenting an attractive financial regime for manufacturing investment. Now that the FAP has been abolished, the fiscal incentives must stand alone and be compared directly with fiscal treatment of manufacturing elsewhere. Arguably Botswana’s profits tax regime is less attractive for investment than that offered by a number of regional competitors. Many of them, including South Africa, Zimbabwe and Namibia, offer tax holidays for manufacturing, especially where it is conducted for export within export processing zones (EPZs). On the other hand, Mauritius, which is perhaps the major competitor for textile investment for preferential export markets, has a broadly similar level of taxation.

Other positive features of Botswana’s investment climate can neutralize its tax disadvantages and there is no pressing case for change in rates. However, the withdrawal of FAP means that highly mobile manufacturing investment will be more sensitive to these disadvantages; they should therefore be kept under review. There could be a case for providing faster depreciation of plant and machinery used in manufacturing in a manner which is both attractive to investors and fiscally prudent. The termination of the FAP scheme means potential budgetary savings. Thus there should be some breathing space to accommodate the deferral of tax receipts caused by the accelerating capital allowances. Introduction of faster depreciation would be a useful “still open for business” signal following the abrupt termination of the FAP incentives.

Several countries in the region also offer, through EPZs, customs duty exemption for imports used in manufacturing exports (such as garments). Botswana has a well-administered, general system of duty exemption for export processing. Thus Botswana is not a case where unattractive general taxation or poor customs administration warrants the creation of a free trade zone, as the system for export manufacturing functions in a manner akin to a well-run free trade zone.

d. Potential for further investment initiatives: tourism and utilities

The *tourism* business has grown rapidly over the last decade; it focuses on a high-value niche offering products related to wildlife and the wilderness, but has no specific incentives. Although it was added to the FAP programme in 1988, only 14 medium and large projects received FAP incentives (amounting to less than 1 per cent of the total value of grants approved by 1999).

Development of the tourism industry has been ecologically sound and, as a result, sustainable. However, tourism has grown from a tiny base and remains a small industry that still has unexploited potential in terms of expansion and attracting FDI. For example, the industry employed 2 630 workers in 1988 and only 9 900 in 1998 (Hotel and Tourism Association of Botswana). In marketing, infrastructure and air links it remains a satellite location in regional ecotourism. The private sector is not pressing for incentives, but investment would benefit from bolder Government initiatives.

The Government provides essential basic elements including a high standard of law and order and personal security for tourists and careful wildlife conservation. But elements of the investment climate should be improved if the sector is to develop further with the participation of FDI. These include: better infrastructure, liberalization of air transport, a positive attitude towards large-scale projects in certain suitable areas,³⁰ longer land-use terms for large projects, removal of unnecessary or duplicated regulatory approvals,³¹ a more flexible approach to non-citizen work and residence permits, and a partnership approach between the private sector; tribal land owners and the parks and wildlife service to concessioning areas of tourist potential with investor responsibility for wildlife conservation to agreed standards.

Current policy should be geared towards creating these conditions for an improved investment climate rather than being too concerned that foreign investors are pre-eminent in the industry (table II.6 shows, for example, that the greatest proposed FDI restriction is in tourism). Should this be such a priority for Government action in a still small industry with potential for further expansion that employs less than 10 000 people? Concern about the foreign role in tourism might be addressed in different ways. For example, it is striking that almost none of the safari camps have apprentice local managers; incentives could be provided to encourage this.

As noted earlier, the major *utilities* have, for the most part, achieved reasonable coverage and good operational standards under Government ownership; these are achievements.

Investors point to problems such as slow connection times for customers and relatively high charges but do not highlight these as significant negative factors. At the same time, sound public finances means that there is no fiscal imperative to seek private investment. These factors have all sapped the motivation to open the sector to private investment and the benefits of competition.

However, they are also the conditions which permit liberalization of investment in the sector to have a strong impact and to gain public support. A bolder approach should be considered.

- ◆ Given the status of network coverage and technical standards, privatization may not need to be accompanied by a period of exclusivity in order to support massive “catch-up” investment. It may be possible for privatization and liberalization to go hand in hand, and thus for competition in service provision to be achieved quickly. This should be a source of encouragement to Botswana, because it is vital for privatization to lead ultimately to greater competition in order to deliver benefits and not simply to replace a public monopoly with a private one. This is not always easy to achieve. Lessons can be learned from the experiences – good and bad – of other privatizations, for example in utilities, in achieving competition, including the sharing of backbone infrastructure.³²
- ◆ In the context of privatization through trade sales, the Government could set aside some shares for free distribution to all citizens. There is no budgetary need to sell all the shares, and this would help achieve public support for the process. There is experience of such schemes in Eastern Europe, and Botswana would be able to implement a similar scheme on a much more controlled basis.

³⁰ As noted earlier, many of the wilderness areas in Botswana do not lend themselves to large projects.

³¹ HATAB claims that still too many licences and permits are needed to establish and operate a tourism business.

³² For example, the United Kingdom has introduced strong competition leading to falling prices in gas and electricity distribution and in electricity generation with private grid ownership, but has been notably unsuccessful with the private monopoly of the rail infrastructure.

D. The proposed foreign investment code and related issues

I. Review of the code

Botswana is one of the most successful of all small developing countries in attracting and managing FDI to achieve economic growth and transformation. For over 30 years of independence it has had an open and welcoming regime for foreign investors. Foreign investors have been treated well and have been able to conduct business in a fully functional legal and economic climate.

Moreover, as far back as 1982, the Government identified Botswana's potential vulnerability in relying too heavily on FDI in diamond mining as the pillar of modernization. It launched an ambitious scheme – the FAP – to accelerate economic diversification. The scheme offered incentives equally to national and foreign investors for medium and large-scale projects. The FAP leveraged a key relative strength of Botswana, namely its large public revenues from diamond mining, to offer investment incentives that few others could match.

Despite this history, the Government has recently circulated a proposed foreign investment code that represents a tightening of the FDI regime in Botswana. This goes against the modern global trend of liberalizing conditions for entry and treatment of foreign investors. It would seem that special circumstances in Botswana have led to a faulty diagnosis of the issues relating to FDI. The Code would introduce three new general restrictions on the entry of FDI.³³ These are in addition to the “reserved activities” controls that reserve certain trading and manufacturing businesses for wholly nationally owned investors. The principal new restrictions would require certain minimum amounts of investment by foreign shareholders, as shown in table II.6.

Table II. 6. Proposed foreign investment code: Minimum amounts of investment
(Dollars)

SECTOR	MINIMUM INVESTMENT		PER ADDITIONAL INVESTOR
	100 PER CENT FOREIGN	JOINT VENTURE	
Manufacturing	100 000	75 000	50 000
Trading	150 000	100 000	75 000
Tourism	200 000	100 000	10 000
Other non-financial services	75 000	50 000	37 500
Construction	100 000	100 000	75 000
Property development	100 000	75 000	50 000
Information Technology	50 000	25 000	25 000
Agriculture	75 000	75 000	--

³³ There are also a variety of restrictions applying to investment in financial services. For example, insurance companies must have paid-up share capital of at least 2 million pula; while the minimum capital requirements and risk exposure for banks and other financial services is determined by the Central Bank.

It is not clear if these amounts are equity or total funding from abroad, which may include shareholder and/or third party debt.

- (ii) Applicants for manufacturing, trading, or tourist enterprise licences must have prior deposits in Botswana of investible funds and must propose to employ at least 10 citizens.³⁴
- (iii) Granting of work and residence permits to new entrants is contingent upon their having been previously issued an operating licence.

The Government's reasons for the proposals include its aim to:

- ◆ Attract only "serious" (i.e. substantial) foreign investors;
- ◆ Admit only "bona fide" foreign investors;
- ◆ Curb economic refugees who may take away jobs from citizens; and
- ◆ Protect small local investors and open investment opportunities for them.

Some of these issues have been highlighted by the failure of the Motor Company of Botswana (see box 1.2). However, it is suggested that, on more careful analysis, these reasons do not support introduction of the proposed code for the following reasons:

- (i) The problem with selecting "serious" investors through size criteria is that it ignores the power of ideas, innovation and the drive to succeed and take risks, which comes from entrepreneurs. Business history is full of examples of great businesses that grew from small foundations. There are bound to be examples of successful foreign investments in Botswana that would not meet the size criteria if they were started today, especially, but not only, in service industries (e.g. in support services using computers, in which there are fewer economies of scale).
- (ii) The regulation of "bona fide" investors is not an issue of foreign versus national investment. The need to regulate the entry of new investors arises when:
 - ◆ *Failure of one investor causes systemic risk (i.e. risk of wider collapse) and entry must be regulated on prudential grounds.* This is the case in banking, obviously, and also, arguably, in the case of tourism, where unacceptable performance of some operators may affect the image of the industry as a whole. But in these sectors each application must be considered on its merits, irrespective of the source and size of the investment. In banking, for example, a foreign bank is not necessarily more prone to failure than a national bank. Nationally owned banks can fail (there are many examples throughout Africa) and so can foreign banks BCCI is a case in Botswana and elsewhere). But systemic risk is not an issue in manufacturing and in most business and consumer services. If a foreign investor in these areas fails, it is unfortunate; but it does not cause systemic harm to Botswana.

³⁴ They are also required to transfer technology to Botswana; to involve Botswana nationals in management and supervisory positions; and to develop training programmes to enable expatriate positions to be localized within an agreed time period. (It is not clear how this would be enforced.)

- ◆ *Investment gives rise to exclusive rights.* This applies in mining, telecommunications and, potentially, in aspects of ecotourism. In mining, for example, an investor is granted exclusive rights to prospect and mine in licensed areas in return for undertaking an appropriate exploration and mining programme. The mining investor must have adequate financial and technical resources. However, the need to ensure that the investor is bona fide applies to both national and foreign investors.
 - ◆ *Public funds are granted as incentives in return for a promised investment.* In these cases there is a need to establish that the investor is bona fide. But an investment size criterion does not filter out undesirable foreign investors. The Motor Company of Botswana was a substantial investment for example. Moreover, there are no grounds to claim that foreign investors are more prone to abuse incentive systems than national investors. The fourth FAP evaluation did not find this to be the case in respect of that scheme. Of course opportunistic foreign investors may respond to especially generous cash incentives and leave when the incentives run out; this is not necessarily abuse, but it points to the need of ensuring that incentives are more carefully designed to help create sustainable investment. The phasing out of FAP should eliminate a potent attraction for “fly-by-night” investors. The proposed code will prohibit all FDI outside the guidelines, whether or not it would benefit from incentives. However, this is not a logical solution to poor design or execution of incentive programmes.
- (iii) Control of economic refugees is perceived as a serious and growing problem. The Government believes unwanted immigrants can pass themselves off as investors in order to obtain manufacturing, trading or tourism licences and present such licences to the immigration authorities as evidence of financial capacity under the Immigration Act to obtain residence visas. Recently, the President’s Office has instructed that work and residence permits must henceforth be obtained before the issue of a licence.

It is doubtful whether the size thresholds will relieve the pressures of economic immigration to any significant extent. They will, however, sharply slow down the application rate from foreign investors for licences, or the success rate of applications. But would-be economic migrants seeking to get into business could simply resort to other devices such as creating as “fronts” nationally owned companies. Judging whether applicants for work and resident permits are sponsored by genuinely nationally owned businesses is not easy and will increase corruption pressures. It will burden the already overstretched work and residence permit system and delay further the issue of permits to genuine cases.

On the whole the reasons given for the imposition of minimum investment thresholds are not convincing. Also, there are doubts as to whether they are compatible with Botswana’s objectives of diversifying the economy and increasing competitiveness for the following reasons:

- ◆ The code could cut Botswana off from useful flows of FDI from regional sources, especially for manufacturing, tourism and other services, including support services – bearing in mind that Botswana is unlikely to be a destination for FDI in large-scale manufacturing. Perusal of data on industrial licence applications strongly suggests that investment in manufacturing would suffer;
- ◆ Genuine national businesses will be deprived of the opportunity of forming partnerships with foreign investors who could add missing dimensions to their business;

- ◆ Abuses such as fronting³⁵ will be stimulated and will damage the image of foreign investors as a whole in the eyes of the community;
- ◆ Botswana's sound economy and attractive investment climate is an opportunity to attract relocating and other smaller businesses if carefully handled. The proposed policy sends an unhelpful signal to the international investment community – this at a time when a neighbouring country is souring perceptions of the regional investment climate and when host countries are competing to attract FDI. This point about competition for investment has been appropriately mentioned in a recent ministerial speech;³⁶
- ◆ Stimulating local businesses through restrictions and administrative measures rarely works. There are examples of countries which restricted or even removed foreign investors, but local businesses did not take their place. On the other hand, foreign investors can be encouraged to nurture local suppliers. Many will respond well to a positive and consistent climate created by the Government (and, equally, will react badly to coercion or efforts to require them to subsidize suppliers or users). Debswana, for example, has created a fund to support national investors and national-foreign partnerships for mine- and non-mine-related businesses (box I.6).

2. Recommendations on the foreign investment code

It is recommended that the proposed code in its present form not be enacted. Banning all FDI under a certain size is too blunt an instrument, and the conditions relating to work and residence permits should be modified. An alternative approach is recommended below. It separates the issue of immigration from FDI, and places a more helpful perspective on current restrictions in sensitive businesses. The recommendations are as follows:

- ◆ Retain the reserved activities approach, where FDI is regarded as an unacceptable threat to citizen-owned business, and where there is an adequate supply of local skills to undertake investment, and ensure adequate competition (with monitoring by the competition authority, when it is established). However, there should be flexibility to enable established (not start-up) citizen-owned businesses in these areas to grow and improve their operations by bringing in foreign partners.
- ◆ Prior deposit of investible funds could be restricted to those cases where the proposed business entails investments of below, say, \$25,000, or employs less than 10 people (or such lower thresholds as are necessary to delineate the vast majority of “economic refugees”). This would apply whether the investment is ostensibly national or foreign.
- ◆ Replace the minimum-size thresholds for FDI with a post-investment audit system. This would require all investors (whether national, foreign or joint ventures) who seek work and resident permits for non-citizen staff to state the proposed size of investment or expansion. Normally, such investors will have passed through one or other licensing procedures first. Issue temporary (18 month) work and residence permits, as justified. Convert the temporary permits to the standard permits within 18 months on the basis of the first normal statutory audit of the company's accounts that shows whether the proposed investment funds have been committed. (Detailed recommendations on work and residence permits have been given in section B.4 above).

³⁵ A practice in which investors of record are a façade for effective control exercised by others.

³⁶ The Minister of Commerce and Industry, in a statement to the Committee of Supply, said: “We must recognise that in today's global economy, there is stiff competition amongst all countries, particularly developing ones, for investors.” (March 2001: 5).

- ◆ These changes can be implemented outside an investment code. However, it is recommended that Botswana take this as an opportunity to introduce an investment code which consolidates international best practice aspects of legislation dealing with FDI, such as property rights and ease of entry, national treatment, non-discrimination and dispute settlement. Restrictions on the grounds of national sensitivities should be a small marginal part of the code that should signal to the world the historical reality that Botswana is a welcoming place for investors.

E. Assessment and recommendations

Since independence Botswana has been substantially open to FDI. Foreign investors have been treated well, general legal standards for business are functional – often excellent – and economic conditions have been well managed. Administration of business regulations has been fair and free of corruption, although some inefficiencies are apparent.

Botswana has successfully attracted FDI in areas where it is strongly endowed – diamond resources – and has managed well the economic and fiscal pressures relating to large-scale mineral resource development in a small economy. Public revenues resulting from FDI-led mineral development have been ploughed back into the provision of public goods and services, resulting in the transformation of Botswana's economy and society.

FDI has also led to more recent growth in tourism and manufacturing, and is a modernizing force in financial and business services. In manufacturing, a commendably ambitious incentive scheme was developed in the 1980s to provide an impetus to economic diversification.

FDI policy is now undergoing a re-evaluation. This is perfectly appropriate, given the scale and depth of FDI in the economy and the rapid change in Botswana's circumstances that it has helped to bring about. But policy towards the entry of FDI is becoming unduly afflicted with doubts and caution; the regulatory regime is becoming less helpful to foreign investors in their business requirements; dilatory privatization is restricting new FDI opportunities and investment-support initiatives are becoming timid. This is in contrast with the growing liberalization trend of FDI regimes elsewhere in the world. Much of this re-evaluation has emerged in a proposed new foreign investment code. It would seem that Botswana's FDI policy changes are in part based on a faulty diagnosis of the issues and are unlikely to be in its best interests, especially given events in at least one neighbouring country that could damage the investment climate in the region as a whole.

Adoption of the proposed new foreign investment code is not recommended. Rightly or wrongly, economic migration is causing concern, but the proposed code is not a sufficiently targeted solution, and it will deprive Botswana of useful investment. Further, the need for investment screening to avoid abuse or to permit only bona fide investors is, if correctly analysed, not an FDI issue.

Table II.7 summarizes recommendations for change made in this chapter on the policy and operational framework for FDI. Without doubt, the most important elements of the investment climate are sound and good policy which has served Botswana well. Botswana is a leader. The recommendations made here are aimed at maintaining this leadership in the face of a new set of challenges and opportunities.

Table II. 7. Summary of recommendations

ISSUES	RECOMMENDATIONS
FDI ENTRY:	
Proposed foreign investment code	Do not introduce in its present form, which provides for investment size thresholds. Maintain reservation regarding certain activities, subject to allowing joint ventures and ensuring adequate competition. Consider a better-balanced FDI law with strong investor protection.
FDI as a channel for economic migration	Better conceptual separation of FDI and immigration is needed. Allow prior work and residence approval for small investments only and all others on a post-investment audit system.
Permit only “serious” and “bona fide” investors	This is not an FDI issue <i>per se</i> . Screen by sector not by nationality of the investor, and only where there are systemic risks, exclusive rights, or contingent financial (not fiscal) incentives.
TREATMENT AND PROTECTION OF FDI	
Small BIT network	Expand on two principles: <ul style="list-style-type: none"> ◆ support initiatives such as the IFSC; and ◆ respond to home-country requests
OPERATING CONDITIONS	
Slow and problematical issue of work and residence permits for non-citizens	(i) A 5+5+5 policy is recommended. (ii) Publish processing statistics for benchmarking.
Peri-urban land scarcity	Tenure, re-zoning and more private investment in land development needs to be examined. Preventing a possible speculative squeeze should be an early task of a competition authority.
Licensing	Simplify industrial licences to speed up the licensing process.
Competition	Accelerate the introduction of a competition law.
INCENTIVES AND SECTORAL INITIATIVES	
General	Continue the sectoral approach, but more boldly.
Manufacturing	Consider higher rates of capital allowances as a counterpoint to competitors’ tax holidays.
IFSC - Expand on well-judged initiative	Allow offshore banking units to borrow locally
Minerals – insufficient non-diamond activity	Consider a more attractive fiscal regime.
Tourism	Work on a wide range of measures, including integrated

III. STRATEGIC PERSPECTIVES

Introduction

Diversification of the economy, away from its substantial reliance on diamond mining, and rapid growth remain Botswana's overriding economic objectives, confirmed in an official national document called *Vision 2016*. The role of FDI in pursuing these objectives will remain critical in all sectors, as Botswana continues to need the components of the FDI package, especially managerial, technical and professional skills, hard and soft technologies and access to, and knowledge of export markets.

This requires an FDI strategy rooted in Botswana's existing investment attractiveness, conferred by its excellent governance, but embracing additional, more proactive elements. These include: taking full advantage of market access arrangements; reinforcing such temporal advantages by attention to sustained, long-term policy actions aimed at direct competitiveness factors; the encouragement of local private business, and the development of human resources; and ensuring coherence and consistency of Botswana's policies, including investment promotion efforts.

A. Investment potential

At the *country level*, Botswana scores high on several international indices with regard to the investment climate. Among them, a SADC investor survey of the investment climate of its member countries, singled out Botswana as a "best practice" example on indicators of good governance, sound fiscal policies and high growth rates over a sustained period. It ranks third on the African Competitiveness Index 2000, after Tunisia and Mauritius. More importantly, in the region it stands out as a country with a history of stable democratic politics, good labour relations and a low crime rate. In 2001 it was awarded the highest credit rating of any African country. In addition, it has a well developed physical infrastructure, including roads, utilities, and telecommunications. Botswana has 40 telephones per 1 000 people, as compared to an average of 18 for Africa. Primary and secondary school enrolments are high and this is reflected in the high per capita expenditure on education. Education expenditure per capita for Botswana is around \$153 as compared to \$16 for Ghana and \$7 for Uganda.

However, in the competitive environment for FDI, industry-sensitive factors will have a decisive effect on whether Botswana will succeed in attracting FDI and benefiting from it in terms of the diversification of the economy. The pursuit of the national diversification objective is not a matter of choosing either manufacturing or services as the pillar of growth and diversification; rather, maximizing opportunities across the board is required³⁷, including in manufacturing, services and non-diamond mining. These are the sectors that will drive diversification and must be the core of Botswana's FDI strategy. Yet Botswana's strategic preparedness to attract FDI into these sectors and industries within them varies.

³⁷ The Bank of Botswana's annual report for 2000 reviews opportunities for financial services as a healthy corrective to the manufacturing push of the last 20 years.

At the sector level, several strategic conclusions stand out.

The inflow of resource-seeking FDI is probably lower than its potential in *non-diamond mining and tourism*. Non-diamond mining does not appear to be on a sustained growth path. The copper operation is struggling, and major mining companies have not been attracted outside the diamond sector. There are weaknesses in the policy environment, as discussed in Chapter II. Botswana's good governance does not compensate for these policy weaknesses in mining because international mining investors are often able to develop methods of investing in quite adverse governance regimes. By contrast, a good governance regime is much more important for tourism (although even in tourism it has been possible to carve out enclaves which are quite isolated from domestic economic and security considerations). Tourism has grown rapidly based on ecotourism. It is still a small industry and appears to have the potential to attract more FDI to continue this growth path.

Given Botswana's small domestic market, FDI in *manufacturing* is driven mainly by preferential trade arrangements giving access to international markets. The future shape of these arrangements will subject Botswana to strong cross-currents – some will weaken existing preferential access while others will create new opportunities for FDI to locate in Botswana. A powerful trend is for Botswana's market access to be shared with more competitors. To that extent, FDI location will be increasingly efficiency-driven and Botswana will need to offer superior locational advantages against its competitors. In terms of geographic location, such advantages include access to the Johannesburg area (which is a major market, accounting for some 40 per cent of South Africa's GDP) and/or to Johannesburg-based transport facilities. But apart from this, Botswana offers foreign investors weak competitiveness in terms of costs and productivity, supply of local skills and linkages to local suppliers. Furthermore, its superior overall business climate can be substantially mitigated by the formation of export processing zones (EPZs) in competitor countries. These themes of market access, competitiveness, local business development and human capital are discussed below.

Financial and business services have achieved above 8 per cent real annual growth but are currently domestic-market oriented. As such, their growth will be constrained by the rate of general economic growth, plus opportunities due to financial deepening, unless they become more outward looking. In these services, good governance and the overall investment climate are important, but not sufficient elements for attracting FDI into regional service operations. Competitive supply of telecommunications, transport services, office and residential accommodation as well as skills, are required, and Botswana lags behind South Africa in this regard. Botswana also has untapped potential in business services, and specifically in its ready supply of numerate and literate (moreover, in English) school leavers, who could readily be trained in software and service skills. Botswana is well ahead of the rest of Africa in this respect. This could be honed to give Botswana a critical comparative advantage for the export of services such as call centres, data entry and analysis, and other back office service work of foreign companies in which human capital, rather than geographic location, is significant. These services, using electronic communications, would not suffer from the comparative disadvantage of transport costs faced by trade in goods.

Infrastructure services. Telecommunications, water, electricity and transport are strategically important for a diversification strategy. Unless investment in these sectors keeps pace with economic growth, they are likely to become bottlenecks when the overall economy is growing rapidly. Furthermore, poor quality services and network coverage will hinder future investment and growth. The quality of infrastructure services also has an important bearing on Botswana's competitiveness in the provision of business services – a factor that will become more significant in attracting future FDI. With good financial management and access to government equity and local debt finance, the State-owned companies providing infrastructure services seem eminently capable of developing their capacity. However, there is little or no competition to improve cost and quality of service to customers. Under the right regulatory conditions, private investment, including FDI, can play a role in introducing greater competition. The formulation of this role should be part of Botswana's FDI strategy, as discussed later.

None of this is to deny that good governance and the overall investment climate are important factors in presenting an attractive profile for FDI. The Investor Survey undertaken for this review confirms their importance to existing investors in Botswana (see annex). Poor governance imposes additional costs on business and makes countries less attractive to FDI. In the absence of examples from Botswana or the region, box III.1 illustrates the scale of the problem, using an example of transition countries. Botswana's advantages conferred by its excellent governance and overall investment climate must be maintained. However, these advantages need to be reinforced by industry-specific and direct-competitiveness factors, as identified above and discussed below, leading to a strategic agenda for maximizing FDI potential.

Box III. 1. Business costs of poor governance

A survey of transition economies of the Commonwealth of Independent States (CIS) and Central and Eastern Europe measured the cost to investors of selected elements of poor governance.

“Time tax” indicates the degree of State involvement in ordinary business decisions, as measured by the extent of management time spent dealing with officials to gain regulatory approvals. For private firms the average was around 10 per cent.

“Bribe tax” indicates the cost of corruption as measured by the value of bribes paid as a percentage of revenue “in order to get things done.” The average bribe tax was 5.7 per cent in the CIS countries and 3.3 per cent in Central and Eastern Europe. Moreover, the burden was highest on new entrants.

These levels of bribe tax would represent a high percentage of operating margins in many sectors, and especially in those where operating margins are the thinnest. Thus they have a strong impact on investors who seek efficiency gains by investing across borders.

Source: European Bank for Reconstruction and Development, Transition Report 1999.

B. Elements of an FDI strategy

I. Market access

Export-market access is the key to attracting to the small Botswana economy FDI in manufacturing, including food and raw materials processing. Botswana has been the beneficiary of a number of trade agreements that confer preferential access to much larger markets (box III.2). Arguably, Botswana has not taken full advantage of the opportunities this provides to attract investment and should intensify efforts to tap the opportunities as long as they exist.

Box III.2. Botswana's trade agreements

SACU. The Southern African Customs Union, established in 1910, comprises South Africa, Botswana, Lesotho, Namibia and Swaziland. It has a common, relatively high external tariff and free trade between member countries.

South Africa-EU Free Trade Agreement. This agreement between SACU's dominant member, South Africa, and the European Union took effect in January 2000. It will liberalize the majority of tariffs on trade in both directions over a 10 – 12 year period.

SADC Free Trade Agreement. Botswana and the other SACU members are part of this broader initiative among most of the SADC States to reduce tariffs on trade within their combined market of 200 million people. Reduction of tariffs on most trade began in 2000. Tariffs on sensitive products will be liberalized in stages from 2008. Individual States will choose the extent and speed of liberalization within this timetable. The SACU States will be among the early liberalizers.

Cotonou Agreement. This is a new 20-year framework agreement concluded in June 2000 to succeed the Lomé Convention between the EU and African, Caribbean and Pacific Countries (ACP). In addition to establishing the basic provisions for development and political cooperation, the Cotonou Agreement requires the negotiation of a series of Regional Economic Partnership Agreements, providing for fully reciprocal free trade and investment between the EU and subregional groupings or individual ACP States in specified areas. During a transitional period, improved trade preferences of the Lomé Convention will be retained until 2007, including the beef protocol that benefits Botswana.

AGOA. The Africa Growth and Opportunity Act of May 2000 extends additional preferences for Botswana and selected sub-Saharan countries into the United States market, initially until 2008. This access is subject to meeting several economic and political conditions as well as customs' control cooperation requirements. Botswana has met the conditions and approval was given in August 2001 for duty-free access of its textiles and apparel into the US. Being a middle income country, it would normally have been subjected to higher origin content requirements, but this was waived and it would be considered like other poorest African countries (of per capita GNP below \$1 500) for waiver on the United States' content requirement until 2004.

Box table. Direction of Botswana's trade, 1999

Country/region	Exports, excl. diamonds		Imports	
	\$ million	Per cent	\$ million	Per cent
SACU, of which South Africa	194	53.9	1 524	76.2
Other SADC	26	7.0	79	3.9
EU	117	32.5	176	8.8
US	11	3.0	36	1.8
Other	13	3.5	186	9.3
Total	361	100.0	2 001	100.0

Source: Trade data are provided by Botswana Institute of Development Policy Analysis

Botswana is a large exporter of chilled and frozen beef to the EU, but has never filled its quota, while exports to that market stagnate. Botswana has taken minimal advantage of tariff preferences for canned beef exports to Europe where it ranks behind Zimbabwe as a supplier (exports halved between 1996 and 2000). Recently started exports of denim fabrics and clothing have risen rapidly, but Botswana has not yet been as successful as, for example, Mauritius, in attracting FDI to the clothings and textiles industry from Asian investors facing quantitative restrictions on exports from their countries. Yet, as far as can be predicted, the future international trading landscape could become less favourable to Botswana, as present special advantages will gradually diminish and more favourable market access accorded to potential competitors. FDI will be important for identifying and seizing selective trade opportunities and responding to the competitive pressures that emerge.

How is the changing international trading landscape likely to affect Botswana's prospects for attracting export-oriented FDI?

In broad terms, Botswana is likely to get even more liberal access to regional and extra-regional markets, and this will be more durable; hence, in principle, it should be more attractive to investors. More liberal access will be provided through the EU Regional Economic Partnerships (REPs), the United States' AGOA, SADC regional market opening, and the Doha Round of the WTO (with favourable developments expected in such areas as agricultural tariff quotas and textile tariffs in the United States, Japan and developing countries); in addition, competing export and domestic subsidies (e.g. for beef and canned products) are likely to be reduced. Therefore the market is likely to expand over the medium term. But Botswana needs to put more emphasis on raising its international competitiveness to exploit that potential as long as it exists and is available on preferential terms. This emphasis is all the more necessary as growing reciprocal commitments (through, for example, REPs, SADC and the Doha Round) will increase pressure on domestic production as well.

Future developments having implications for trade and investment in Botswana are discussed below:

- ◆ Botswana offers investors an “offshore” location for duty free access to the South African market through its membership of SACU. However, this attraction will gradually weaken as a consequence of the South Africa-EU Free Trade Agreement and South Africa's commitment to extend duty free access to all SADC States via the SADC Free Trade Agreement. Botswana is thus faced with many more competitors for FDI aimed at duty free access to the South African market, some of which have more sophisticated industrial capabilities, such as Mauritius and Zimbabwe.
- ◆ Botswana has the potential to offer more liberal access to investors targeting markets in other SADC States due to the SADC Free Trade Agreement. This includes relocating South African investors.
- ◆ Botswana's preferential access to developed country markets for exports will depend upon:
 - The ability of subregional countries to develop an advantageous partnership agreement through the Cotonou Agreement with the EU;
 - Botswana's ability to find competitive advantage in AGOA.
 - The evolution of new EU free trade agreements with other regions; for example an EU agreement with the Southern Common Market (MERCOSUR, comprising Argentina, Brazil, Paraguay and Uruguay) is likely to affect Botswana's preferential exports to the EU market for beef.

- ◆ Continued liberalization of world trade under WTO agreements, especially under the work programme adopted by the Fourth WTO Ministerial Conference in Doha in November 2001 could adversely affect Botswana's exports. Developed countries will remove their restrictions on textile imports from Botswana's Asian and Latin American competitors by the beginning of 2005, which will intensify competition on world markets; furthermore, Asian textile investors will no longer need to move abroad to supply the markets of the EU or the United States. The Doha work programme will likely lead to the further liberalization of EU beef imports under the most-favoured nation (MFN) clause, which may lead to erosion of the special access regime to Europe for ACP countries. On the other hand, competitive Botswana beef could benefit from larger and dynamic low-duty MFN quotas and a removal or reduction of export subsidies.
- ◆ Botswana has the possibility to take advantage of opportunities provided by new trade and investment agreements. The United States has agreed to negotiate a mutual trade and investment agreement with SADC. Such an agreement could have far-reaching implications for Botswana in accessing FDI from the United States, and from other home countries targeted at exports to the United States.

A discussion of general trends in market access for manufacturing can only go so far. Individual *products* can require fairly complex market-access considerations. Identification of these considerations for export-oriented FDI is part of the systematic approach to investment promotion recommended later. Two examples of the complexity are given below.

Clothing is one example. As noted earlier, preferential advantages in developed markets for Botswana clothing manufactures will diminish as quotas under the Multi-Fibre Arrangement (MFA) are eliminated. From 2005, ACP producers will have to compete on world markets without the advantage of quantitative restrictions being imposed on Asian suppliers. In the EU market, ACP exporters will continue, for the time being, to enjoy preferential tariff margins of around 12 per cent on main clothing, but the removal of quotas is bound to bring more direct competitive pressure from the most efficient Asian exporters. (Botswana's exports to the EU of denim fabrics and clothing products – mainly made of synthetics and partly of cotton – rose from \$2.4 million in 1996 to \$16.2 million in 2000). In the United States market, Botswana is able to enjoy duty-free access for exports of clothings under AGOA I up to 2004, with waiver of apparel items using US fabric or from yarn or fabric sourced from other African countries that have an AGOA-compliant visa system in place. In the second phase of AGOA up to 2008 Botswana will likely have to meet with stricter origin requirements, and it would have to contend with competition from Central American and Caribbean countries which already enjoy similar preferential market access arrangements.³⁸ The higher origin requirements will impose the use of either US fabrics in its apparel items or yarns and fabrics originating from other AGOA beneficiaries (such as South Africa, Kenya or Mauritius thus far) within an overall United States ceiling.

Chilled, frozen and canned beef also exhibit a series of complex but different considerations, including the extent to which a new WTO round will reduce European protectionism and subsidies (high MFN tariffs are likely to remain in place, especially for imports above the MFN tariff quotas), the prospects for EU enlargement, and the implications of improved access by Brazil and Argentina to the EU under a future EU/MERCOSUR trade agreement.

³⁸ Botswana was declared eligible for AGOA in October 2000, with effect from 21 December 2000. It also became eligible under the AGOA Apparel Provision since August 27, 2001. There were no exports benefiting from AGOA during the period January–June 2001. Exports from Botswana to the United States under the Generalized System of Preferences (GSP) decreased from \$1.5 million to \$0.6 million during that period.

Botswana has unexploited opportunities to attract efficiency-seeking, export-oriented FDI in manufacturing industries due to preferential market access arrangements. As the attractiveness of some of these opportunities may diminish or even disappear over time, they should be tapped as soon as possible for as long as they exist. While working hard to retain or even expand its liberal access conditions, Botswana should, at the same time, be able to offer attractive locational advantages against other competitors for FDI. This includes targeting existing investors whose entry to Botswana was based on specific market advantages.

2. Increasing competitiveness

Competitiveness in the provision of business inputs will become increasingly important in Botswana's FDI strategy. Botswana's diversification objective means that it must attract more efficiency-seeking, export-oriented FDI for which there is strong international competitiveness. In addition, as discussed above, in spite of Botswana's privileged access to regional and international markets, export-oriented FDI will increasingly be able to choose from a wider range of investment locations. This will put a greater onus on prospective host countries to offer superior locational advantages through highly competitive business.

As mentioned earlier, Botswana ranks high on any broad comparison of competitiveness among African countries, including governance issues. On a narrower comparison of availability, quality and cost of key business inputs, its record is good but patchy. A separate survey has not been conducted on these issues. However, on the basis of independent evidence and investor interviews, it appears that availability and reliability of key business inputs is adequate, but quality and costs can pose problems. This applies to infrastructure and services provided both by State-owned enterprises and the private sector. According to table III.1 on comparative business cost indicators, among countries of the region, Botswana shows the highest costs for electricity, water and telecommunications. Sea freight costs are also relatively high.

Table III. 1. Comparative costs of infrastructure services, late 1990s (Dollars)

	Botswana	Kenya	Mauritius	Mozambique	Namibia	South Africa	Zimbabwe
Air freight to Europe (per kg)	1.84	1.7	2.57	2.18	2.33	1.7	2.2
Sea freight to Europe (per 20-ft container)	2.00	1.40	1.80	1.50	1.08	1.00	2.00
Electricity (per kwh)	0.096	0.022	0.076	0.036	0.036	0.064	0.048
Water (per m3)	1.02	0.35	0.52	0.35	0.67	0.3	0.34
Telecom to EU (per minute)	4.04	4.0	1.65	3.6	1.23	2.21	2.58

Source: Namibian Investors, 1998-1999.

Banking services, which are provided entirely by the private sector, for example, were criticized as being costly and slow, especially by Asian investors who are accustomed to higher standards. The Africa Competitiveness Survey (World Economic Forum, 2001: 264) ranks Botswana 5th best in Africa in terms of time to transfer money to a supplier through the financial system. Yet the average time taken is 18.1 days in Botswana, which, by any absolute standard, is poor. Rentals for prime office and industrial space are similar to those in South Africa, but substantially higher than in Zambia, Zimbabwe and Malawi.

Botswana's FDI strategy should accord greater priority to a package of competitiveness measures designed to make Botswana "best in Africa". This package should include an investment-led competition policy (see also chapter II, section B.6), implementation of the privatization programme and benchmarking competitiveness.

Competition policy should seek to reduce barriers to entry of new investors in all industries so as to encourage competition and innovation. In principle, this should apply both in industries where there are statutory monopolies and where there are none. In relation to statutory monopolies, following a review of the policy towards privatization in 2000 steps are being taken to develop a privatization programme. But there is no drive or sense of purpose behind it, possibly, in part, because there is no fiscal imperative for privatization in Botswana. Some interviewees suggested that the Government might be concerned that privatization could run against its citizen empowerment objectives (see below) if incoming foreign investors install non-citizens in top management. These concerns may outweigh the benefits of competition and private investor involvement that are weakly perceived by the Government.

The privatization debate is too narrowly focused on ownership and control issues, and not sufficiently on how to improve national competitiveness. There could be opportunities for innovative solutions in Botswana because the underlying networks are relatively well developed and there is no financial pressure to maximize sale proceeds. Botswana does not necessarily need to offer exclusive market access to an investor in return for large commitments for network development. Thus it may be possible to abolish exclusive market rights immediately or to provide an industry structure in which parts of a business are open to investment by all investors, newcomers or not. For example, there should be no impediment to competition in international telephony services, even if the public network remains an exclusive right (whether in public or private ownership) for some time to come.

In industries which are not subject to statutory monopoly, new entrants, including foreign investors, should be more vigorously encouraged. Again, banking can be taken as an example because data is available. In 1999 commercial banks in Botswana earned an average 3.2 per cent on assets and 45 per cent on equity (Bank of Botswana, 2000: 112). These earnings rates are exceptionally high by international standards, and suggest a need for greater competition, although the market is small. One recent entrant interviewed was very satisfied with its ability to attract customers.

Botswana does not systematically compare its business costs and services against competitors for investment. This is done in countries with proactive investment strategies such as Singapore. This should be introduced in Botswana and should become a tool for giving priority to policy changes and to investment promotion designed to reduce business costs and improve business services. A central ministry should take the lead role in benchmarking and monitoring competitiveness and in promoting an investment-led competition policy; preferably with technical input and assistance from international and private sector experts. It is a cross-sectoral issue, which should become a major function of the ministry and be included as part of the National Development Plan.

3. Local private sector development

The locally owned private sector in Botswana is still in its infancy. As shown in table III.2, most local activity takes place in enterprises of fewer than six employees, with turnover of less than 60 000 pula, an equivalent of \$14 000 (at 1998 exchange rate). There are only a few hundred enterprises employing more than 100 people, concentrated mainly in manufacturing.

Botswana's entrepreneurial class has remained small, limited in its perceptions of opportunities, slow in responding to them, and insufficiently aggressive³⁹. As a result, opportunities for local entrepreneurs do exist but they fail to be taken up. For example, the UNCTAD survey found many instances where foreign firms were frustrated at their inability to find local enterprises to service their needs: access to local suppliers was listed as the third most difficult aspect of their daily business operations (see annex, figure A.3). A large foreign retailer stated that a shortage of local enterprises offering repair services affects the electrical goods section of its business. The retailer has offered free replacement if faulty products cannot be repaired within a given number of weeks. In many other African countries such repair services would be readily supplied by small-scale entrepreneurs; but in Botswana repairs take a very long time, thus forcing the firm to honour its offer. This means, it essentially gives two new goods for the price of one, and, unsurprisingly, wonders whether it should continue to stock electrical goods. Other examples of untapped opportunities include processed food products: Botswana has not filled its trade quotas on many agricultural products, including meat. Similarly, local enterprise has not emerged to meet the growing demand to supply and service farm machinery or water transportation equipment. Suppliers to the mining sector have not emerged either.

Table III. 2. Private local enterprises in Botswana, 1998

ENTERPRISE CATEGORY	NUMBER	CHARACTERISTICS
Microenterprises Fewer than 6 employees; annual turnover of less than 60 000 pula.	50 000	70 per cent female-owned, operating from rural homes and 30 per cent in urban areas; 60 per cent are in trading; 25 per cent in manufacturing.
Small enterprises Fewer than 100 employees; annual turnover of between 60 000 and 1 500 000 pula.	6000	80 per cent are located in urban areas. 40 per cent in services; 20 per cent in manufacturing; 16 per cent in retail trade; 10 per cent in transport and distribution; and 6 per cent in construction and 8 per cent in agriculture
Medium-sized enterprises Fewer than 100 employees; annual turnover of between 1.5 million and 5 million pula.	300	Mostly manufacturing enterprises.

Source: Government of Botswana, Ministry of Commerce and Industry (1998).

³⁹ This low level of domestic enterprise must, however, be seen in the context of how far the people of Botswana have come in a short time. A population which was very poor, rural and uneducated has made great strides in 35 years, especially given that its education system was (and to an extent still is) geared to meeting public sector needs, rather than to promoting entrepreneurship or responding to the needs of the private sector.

There is impatience in Botswana at what are perceived to be slow results in local enterprise development and some of the blame is levelled at smaller foreign investors. But in the aggregate there is no evidence that FDI overwhelms or “crowds out” domestic investment. Crowding out takes place in financial markets under conditions of scarcity of financial resources or in product markets, where there might be domestic enterprises unable to compete with more efficient foreign firms (UNCTAD, 1999: 171). None of these conditions exist in Botswana: local savings are larger than investment and the local private enterprise sector is small. This is the main reason why mutually beneficial linkages between FDI and local enterprises, which in many countries play a catalytic role in local enterprise development, are rather limited in Botswana (box III.3). UNCTAD interviews have come across a number of instances where small-sized FDI has tapped into investment opportunities which would have simply remained unexploited locally. Yet, undoubtedly, there are instances where individual national investors feel that there is unwarranted competition from, rather than synergy with, foreign investors or foreign job-seekers. Where these are especially acute, the reserved activities policy (in a modified form) within an open FDI legal regime has been proposed in chapter II to deal with this concern. In addition, care should be taken not to confuse FDI issues with immigration issues.

Box III. 3. Linkages: International experience

Backward linkages with suppliers are a common form of linkage between transnational corporations (TNCs) and national firms, especially as modern companies seek efficiency gains from outsourcing and implementing just-in-time production methods. TNCs tend to need stable, long-term relationships with reliable medium-sized suppliers in order to guarantee quality and reliability, especially for export activities that face direct international competition. In more advanced industries, local suppliers also need to have the capacity to continually upgrade technology. These linkages require a well-developed, local private sector in order to succeed. However, it can take time for local companies to develop specific skills. For example, FDI in the electronics industry in Penang, Malaysia began in the early 1970s, but studies show that vigorous supplier development did not start until the early 1980s. Similarly in Guadalajara, Mexico, development of electronics production in the mid-1990s has so far led to little local supplier input. In garment production, assembly accounts for 80 per cent of value added and there is a strong incentive to outsource to low-cost producers. A feature of the Mauritius textile industry is the strong participation of nationally owned firms.

Forward linkages with customers through the use of brand names, including franchising also creates opportunities for national enterprises and can be a source of brand awareness, business systems and training that lower the risk of failure. Again there is a need for national SMEs willing to invest in these opportunities.

The empirical evidence shows that:

- ◆ The production systems of TNCs are evolving towards increasing linkage opportunities for SMEs.
- ◆ Linkages between TNCs and SMEs in developing countries are weak, not because of a lack of opportunities, but due to a lack of efficient SMEs to seize the opportunities.
- ◆ Mandatory local content requirements can lead to weak technology transfer and export performance.
- ◆ Successful national programmes to enhance linkages focus on supporting local SME development and schemes which encourage TNCs to foster relationships with dynamic SMEs.

Source: UNCTAD, 2000.

There is no evidence within foreign firms of a deliberate policy of favouring expatriates in skilled positions, including in managerial positions, at the expense of Botswana nationals. On the contrary, as shown in chapter I, most foreign firms, small and large, have extensive training programmes for local employees, aimed at reducing their reliance on expatriates, who are costly. Recently, training and localization efforts seem to have intensified as foreign firms have become aware of the great importance the Government attaches to this objective. One foreign investor, apart from intensifying its localization programme concerning not only expatriates but also local suppliers, has set up an incubator fund to identify and nurture local start-ups. Looking ahead to the future however, there are growing fears that increased problems associated with HIV/AIDS may deter firms (both foreign and local) from investing in training, and there may be a strong public-interest argument for more State involvement in this critical sector. (This may best take the form of government-financed, but not government-supplied, training). As there is some evidence that local technical training institutions work better when employers are closely involved, the Government could also support this type of cooperation ⁴⁰.

FDI can help Botswana to achieve its objectives of diversification and rapid growth, but it will not accomplish this on its own. Rapid growth of the domestic private sector is essential not only for its aggregate contribution to growth and diversification, but also to maximize the dynamic contribution that FDI can make. Therefore, promoting local entrepreneurship is a legitimate and important national objective. As shown earlier, Botswana has not exploited – or created – the opportunities for entrepreneurs that would have been taken up by other, more entrepreneurial, cultures. It does, however, have a significant means to do so: its population has a sound, basic education and is willing to learn, despite its lack of business or entrepreneurial experience.

The Government's recognition of Botswana's weak entrepreneurial culture and the need to take remedial action is reflected in its 1999 Policy on Small, Medium and Micro-enterprises (SMMEs). The policy represents an integrated approach to addressing past deficiencies in local business development. A number of programmes and institutions have been established to help SMMEs in areas such as financing, technology, standards and counselling. The new Citizen Entrepreneurial Development Agency (CEDA) integrates a financing scheme with direct support measures such as business counselling and mentoring. The Botswana Bureau of Standards, established in 1997, aims to enhance the competitiveness of the private sector by formulating quality standards and helping small companies to meet them. The Botswana Technology Centre (BOTEC) has developed prototype projects, but, according to an interview, the local private sector has not yet been successful in sustaining their commercialization. It recently strengthened its capacity building efforts by establishing a Technical Assistance and Economic Counselling Unit which will help local businesses develop business plans, provide financial advice and following up on the implementation of projects. Training and educational efforts discussed in the next section are a crucial component of this policy. Under UNCTAD's EMPRETEC programme, Enterprise Botswana is helping SMEs to build up entrepreneurial capacity which would include, among other things, to link up more effectively with foreign investors.

The Government should continue to focus on eliminating constraints to local enterprise development and on taking supportive actions. It should avoid the temptation to achieve quick results through administrative measures, including through overly protective measures against FDI. As institutions and programmes dealing with enterprise development are relatively new, care should be taken to make them work effectively. Additional constraints faced by local entrepreneurs that should be addressed include: poor information about government assistance programmes, excessive and complex national laws and regulations that impede development of local SMEs, difficulties in obtaining business premises, and bias towards large firms in, for example, public sector procurement policies.

⁴⁰ This was recommended in the report of the Presidential Commission on Reform of the Incomes Policy.

Additional measures to further encourage entrepreneurship could include the following:

- ◆ Initiatives that help lower commercial risk, to induce greater availability of loan capital to domestic entrepreneurs. For example: reducing the information asymmetries that exist between borrower and lender, reducing the costs of monitoring and enforcing loans, or even supporting microfinance institutions that would help fuel lending to entrepreneurs who lack the credit history or collateral to attract commercial bank support, and are too small to qualify for CEDA or MIGA assistance.
- ◆ Promote more effective joint ventures and co-financing arrangements with foreign firms as a way of tapping into the package of skills and technology, if not capital. These include franchising operations, technical assistance schemes, and subcontracting, all of which offer varying intensities of technology and skills transfer.

4. Human capital development

Botswana faces a considerable shortage of people with skills, experience and aptitude for private sector business and the professions. And this is despite Botswana's significant investment in education since independence. As noted earlier, it is one of the key causes of its weak local private enterprise sector.

Investors interviewed during the fact-finding mission for this report acknowledged Botswana's late start in formal education for key private sector disciplines such as engineering and accounting. In the Investor Survey, investors ranked "access to qualified personnel" as their most significant operating problem and "lack of low-cost skilled labour" as the weakest aspect of Botswana's business environment (see annex, figures A.3 and A.6).

The main explanation for Botswana's gap in skills (and weak local private sector) is the rapidity with which it has transformed from a low-income to a middle-income economy. In less than two generations there has simply been insufficient time to develop capacity for the business skills, work ethic and entrepreneurial culture required for a dynamic local private sector to take off. Contributing to this has been a focus since independence on advanced education in subjects skewed towards developing the skills needed for the public sector⁴¹. Exceptionally fast growth has outpaced the capacity of the education system.

International comparisons give an idea of Botswana's progress and challenges in the area of education. Taking adult literacy as an indicator, table III.3 shows that Botswana is less well endowed than its peers (the "contemporary comparators"). The table (the "historical comparators") also provides a perspective on how well Botswana is equipped, in terms of human capital, to achieve its future growth objectives. Adult literacy is on a par with that of Hong Kong (China), China and Singapore when they began their growth spurt to reach a per capita income level of \$9 000 – now Botswana's objective. It may be significant, however, that both Cyprus and the Republic of Korea, which commenced their growth spurt much later, did so from significantly higher levels of education and, hence, adult literacy.

⁴¹The Government is a major employer and provider of modern amenities: 48 per cent of employees work in Government and related sectors, of which 5.6 per cent work in parastatals. See Central Statistical Office, 2000.

By 1996 (the latest year of comparative data), Botswana was clearly giving priority to public expenditure on education, judging from the proportion of GDP devoted to public expenditure on education. By then Botswana had achieved reasonable levels of secondary school enrolment. However tertiary enrolment was still low. It is likely that more recent data would give a more favourable picture of enrolment ratios in Botswana. However, regional competitors as FDI locations, such as Mauritius, have also been aware of the importance of a highly educated workforce in a middle-income country in which wage costs are relatively high, and have put a premium on raising labour productivity. Moreover, Botswana faces a significant threat to the availability of skilled labour because of its high rates of HIV/AIDS infection (35.8 per cent of the population in 2001), among the highest in sub-Saharan Africa. Recognizing the implications of this problem on future social and economic development, the Government of Botswana is addressing it as a priority on the country's development agenda. A National AIDS Co-ordinating Agency has been set up to implement a national strategy to prevent HIV infection and significantly increase the rates of diagnosis and treatment of HIV/AIDS. It is working in concert with local and global partners on programmes that address prevention, care and treatment. The Government is a partner in the joint initiative on the African Comprehensive HIV/AIDS Partnership (ACHAP), with the Bill & Melinda Gates Foundation and Merck & Company (The Merck Company Foundation)⁴².

The Government is continuing its intensive efforts to accelerate human capital development. In the last 10 years education spending as a proportion of GDP has doubled. Enrolment at the University of Botswana has also doubled. Specific gaps in business-related education are being filled. For example, an engineering faculty was established at the University of Botswana in 1995 and an accountancy college has been started. Investors acknowledge the Government's efforts to close the gaps in formal education, but this does not change the fact that the dearth of human capital remains one of the key constraints to private sector development and development in general. In interviews, the private sector underlined the need not only to close the skills gap, but also to ensure high standards in professional training and accreditation.

In the light of this, an even more expanded, but at the same time more focused, effort is recommended to ensure that education meets the needs of a growing private economy. Given the limited public funds and manpower, the private sector must be encouraged to play a proactive role in achieving national objectives. Companies, both foreign and local, which set up educational institutions that provide subjects deemed a priority by the Government should be entitled to tax benefits. Assistance should be extended for renting or building premises for educational programmes, for importing equipment and instruments, and for bringing teachers from abroad. Special privileges should be considered for educational institutions that are able to attract fee-paying foreign students, a seed of an activity that could be targeted as a future service export industry.

⁴²The Bill & Melinda Gates Foundation and The Merck Company Foundation, will each contribute \$50 million over five years towards the project. Under ACHAP, activities encompass capacity-building, in particular HIV training and education for health care workers; teacher capacity-building; clinical preceptorship programmes for hospitals; building resource centres at district hospitals; and prevention programmes. ACHAP's programme is implemented at the district level, and involves a broad spectrum of aid agencies, both local and global partners. Non-governmental and community-based organizations have received grants and technical support from ACHAP. Merck & Company is also donating anti-retroviral medicines for appropriate programmes developed by the Government. The anti-viral programme will initially target 19 000 affected cases, and later this will be increased to 20 000 affected cases per annum. Merck & Company estimated that if these targets were achieved, Botswana would have the highest treatment rates in sub-Saharan Africa.

Table III. 3. Comparative education profile of Botswana

COMPARATOR COUNTRIES	ADULT LITERACY RATE	SECONDARY SCHOOL GROSS ENROLMENT RATIO (PER CENT)	TERTIARY EDUCATION GROSS ENROLMENT RATIO (PER CENT)	PUBLIC EXPENDITURE ON EDUCATION AS PER CENT OF GNP
HISTORICAL COMPARATORS^{a,43}				
Cyprus (1975)	89.0 (1976)	78 (1975)	2.0 (1975)	4.4 (1975)
Hong Kong, (1962)	71.4(1961)	20 (1960)	4.4 (1960)	2.5 (1965)
Rep. of Korea (1977)	92.8 (1980)	77 (1977)	10.3 (1975)	3.3 (1976)
Singapore (1966)	69.9(1970)	45 (1965)	9.9 (1965)	4.3 (1965)
CONTEMPORARY COMPARATORS (1999)^b				
Costa Rica	95.2	47	30.3	5.4
Malaysia	83.7	64	11.7	5.2
Mauritius	83.3	64	6.1	4.6
Peru	88.8	70	25.8	2.9
South Africa	84.2	95	17.2	8.0
Thailand	94.7	56	22.1	4.8
Turkey	83.4	58	21.0	2.2
Zimbabwe	86.4	49	6.6	n.a.
Botswana	74.6	65	5.8	10.3

Source: UNESCO World Education Report 2000 and Statistical Yearbook 1978-79.

Notes: Unless otherwise indicated, adult literacy rate is for 1997; enrolment ratios and public expenditure data are for 1996. a Year shown in parenthesis is the year when per capita GDP of that country was around \$3,500, or the closest to that year for which data are available.

b Countries with similar per capita income as Botswana.

⁴³Historical comparators: the chosen countries are those that in modern times grew from around \$3 500 GDP per capita (Botswana's status now) to \$9 000 GDP per capita in today's constant prices (Botswana's objective in 2016).

Country	Growth period
Cyprus	1975 – 1988
Hong Kong, China	1962 – 1977
Republic of Korea	1977 – 1992
Singapore	1966 – 1978

Source: World Bank (various years)

Another track is to mobilize the existing private sector, both foreign and local, by encouraging firms to invest even more than they have done so far in upgrading skills and training staff. Firms could participate in vocational training at technical institutes and the University by providing inputs to the curriculum, as well as instructors, and organizing internship programmes for students. This would help the educational system to respond better to industries' needs and trends. In addition, extra-curricular training would also help graduates keep up to date with technology and business practices. This could be achieved through a combination of incentive packages and government financing of training programmes. In addition, the private sector should get more involved in the existing Government-owned educational institutions through greater participation of its representatives in the governing bodies of these institutions.

Finally, one of the best training grounds for future entrepreneurs is to work for an existing foreign investor that offers training in skills not otherwise available in Botswana. It is extremely rare for young people in any country to start up a new business immediately upon finishing their education; typically most gain experience and expertise through the "incubator" effect of working in another firm first. This may be even more important in the context of Botswana, where there is only a small population of local private sector entrepreneurs to impart knowledge and skills.

5. Investment promotion

Botswana's FDI strategy should be coherent and consistent with other policies pursued by the Government, and institutions implementing the strategy should act in concert. It is desirable that the Government avoid policy statements that are inconsistent with its declared policy objectives, expressed in its Vision 2016, to welcome FDI and to rely on the private sector as a source of employment. In particular, the notion that FDI is inimical to the objective of "citizen empowerment" needs to be addressed. Indeed, from the standpoint of promoting FDI, the term "citizen empowerment" should be discontinued or modified in formulating an appropriate strategy and policies for FDI. It suggests that FDI competes with national private investment and therefore must be reduced or controlled. Many in Government believe that restrictions on FDI entry and accelerated localization of employment at the managerial level are necessary to accomplish the empowerment objective. However, the evidence shows that there are no grounds for this premise.

The national growth and diversification objectives require an across-the-board proactive strategy to attract new investments. In such a strategy, FDI attraction is promotion-led and not investment-climate-led. A good FDI strategy recognizes that standards and operating conditions for investors are an asymmetrical force in FDI attraction: a bad investment climate will deter many investors, but a good investment climate will not by itself attract investors. Botswana is rightly proud of the standard of its investment climate, but in the highly competitive area of FDI attraction there also needs to be an institutional structure for investment promotion that is both coherent and comprehensive. This is not yet fully in place in Botswana. Achieving this should be part of Botswana's FDI strategy if it is to be proactive in attracting investment.

How well prepared is Botswana to undertake systematic across-the-board investment promotion? As regards sectors, the investment promotion effort should be extended to all areas with FDI potential. At present, there are two new dedicated investment promotion agencies that have already achieved some success in attracting foreign investors:

- ◆ BEDIA, which concentrates on manufacturing and, to a lesser extent, information technology, and is established with its own board, staffing and office facilities.
- ◆ IFSC, which focuses on non-resident financial services. It is established within the Botswana Development Corporation which funds its budget.

Two other areas with investment potential, mining and tourism, are handled by the relevant government departments. This enables prospective investors to interact directly with personnel with special expertise and with the agency responsible for certain key approvals. But FDI promotion does not seem to be a priority activity of these departments. For tourism, a Tourist Development Board has been established, but its remit appears to be promoting the country to foreign tourists and improving industry standards and local participation opportunities, rather than promoting FDI. The Department of Mines' Annual Report for 1999, for example, lacks information about new investment activity, which is suggestive of a low promotional effort. As a result, investment promotion in these sectors is accorded insufficient priority and resources.

Apart from sectoral considerations, any promotional effort is based on a number of general essential elements. They are summarized in box III.4, and table III.4 gives an indicative assessment for Botswana.

Box III. 4. Conditions for a promotion-led FDI strategy

With an appropriate investment promotion structure in place it is possible to envisage the development of industry- and sector-level marketing campaigns as a central feature of a promotion-led FDI strategy for Botswana. Such campaigns need to encompass all aspects relevant to attracting investors including, but fundamentally not limited to, policy improvements if required.

They must be systematic and rigorously prepared to address issues under headings such as those suggested below:

Policy and operational regime

For each sector does Botswana have:

- ◆ Competitive standards of treatment and policies?
- ◆ Functional administrative practices?
- ◆ Competitive costs and quality and timely supply of business supplies and services?
What needs to be improved to have a credible marketing campaign?

Investment potential

Based on an analysis of the sector's strengths, weaknesses, opportunities and threats (SWOT), where does the potential for FDI reside and how is it best presented?

Investor targets

What is the prospective investor's profile – large versus small/medium; from the region or outside; likely to want a local partner or to be sole owner?

Campaign organization, budget and targets

What marketing tools will be used, what organization will be responsible for marketing and for facilitation, what is the budget and what are the targets and timetable against which results will be measured? How will performance be evaluated and reported?

If these questions cannot be satisfactorily answered, the campaign is premature and could be counterproductive. The formulation of the campaign becomes in itself a tool for ensuring that strategic analysis, policy and institutional reform are tackled.

Source: UNCTAD, 2000.

Botswana's preparedness to promote FDI varies by sector and industry, but some generalization is possible. As reviewed in chapter II, many elements of the investment framework are of high standard. Specific weaknesses have been identified. It is often the case that individual sectors require some fine-tuning of policy and administrative practices, and in that respect the sectoral record is patchy.

Table III.4. Botswana's readiness to promote FDI

SECTOR/ INDUSTRY	INVESTMENT FRAMEWORK	POTENTIAL ASSESSMENT	TARGET IDENTIFICATION	ORGANIZATIONAL STATUS
Mining	**	**	**	**
Mine supply	*	*	*	*
Minerals processing	**	**	**	**
Ecotourism	**	**	*	**
Agri-processing	*	*	*	*
Textiles	**	**	***	***
Light industry	**	*	*	***
Commercial banking and insurance	***	**	*	*
Other financial services	***	**	**	***
Business services	*	*	*	*

Source: UNCTAD

Key: * = poorly developed
 ** = solid development but room for improvement
 *** = well-developed basis for systematic promotion campaign

Most sectors lack a systematic assessment of potential for FDI. For example, in manufacturing this must include a full assessment of current opportunities and a view of near-term potential arising from the shifting currents of international trade agreements, given the importance of market access for attracting FDI. In tourism there is a lack of appreciation of the nature and scale of opportunities for FDI. For example, there are already concerns about the optimal number of tourists in the Okavango delta. However, in part this depends upon the nature of the tourism. Thus a systematic assessment including environmental, wildlife and tourism expertise is needed. There also seems to have been little assessment of the potential for Botswana to attract FDI as a location for business services in the region.

Most sectors appear to have a poorly developed sense of the kind of investors who might be attracted and therefore targeted. In many cases they may be relatively small investors, including from traditional sources such as neighbouring countries, and from non-traditional sources in Asia and further afield in Africa. In such industries it will be unrealistic to approach Fortune 500 companies to invest. On the other hand, there may be cases where a careful assessment of potential suggests opportunities to approach large TNCs to make flagship investments, for example, where Botswana has potential to serve as a location for a TNC's regional headquarters.⁴⁴

⁴⁴ Some firms have already set up their regional headquarters in Botswana, resulting in service exports, with the regional subsidiaries paying their share of regional headquarters costs.

Even within sectors, different sized investors may be appropriate targets for different industries. For example, it may be appropriate to attempt to attract only first-tier banks for commercial banking. But in securities and investment banking, Botswana is unlikely to be attractive to the major global names; here, the attraction of second-tier houses (e.g. from South Africa or Zimbabwe) would be more realistic and appropriate.

Realistic targeting will be especially important in manufacturing. Increasingly, low-end manufacturing of the type under way in Botswana is being decentralized to emerging markets, including in Asia and in some parts of Africa and the Middle East. These are likely to be the home countries of potential investors in Botswana, but could be relatively small, even family-owned businesses. Alternatively, it is conceivable that the upmarket-lodge segment of the tourist industry in Botswana has not sufficiently targeted major industry names.

This is an important context for the often-expressed view that Botswana only wants “serious” investors. One size does not fit all, and careful, realistic targeting is needed as part of professionally organized investment promotion. Sector-by-sector targeting will also demonstrate that across-the-board, minimum-investment-size thresholds (as in the proposed foreign investment code) are inappropriate in an FDI strategy.

Investment promotion and facilitation is organized in Botswana on a decentralized basis. This is perfectly appropriate. Nevertheless, it should be organized to common standards, with adequate budgets and effort, and each promotional agency or departmental unit held to common performance measures. Overall, and despite the successes of BEDIA and the IFSC, Botswana appears to be under-promoted, with promotional efforts lacking sufficient drive. But a full assessment is difficult. The current National Development Plan (NDP) (1997–2003) has the theme, Sustainable Economic Diversification, in which the private sector will play the leading role in development. FDI must clearly be an important part of this. Yet the mid-term review of the NDP makes no systematic assessment of foreign investment promotion (i.e. whether targets, if any, have been achieved, whether the effort is adequately resourced and whether the institutions are appropriately deployed). It receives cursory mention in the mid-term review, and in some cases, it is quite unsatisfactory. For example, it is stated that mineral prospecting activity has picked up since minerals’ reforms were introduced (Government of Botswana, 2000: 124). But no evidence is provided to support this and the relevant ministry does not publish data that enable this conclusion to be evaluated. These matters should be addressed in time for inclusion in the next National Development Plan beginning in 2003. It should set out targets and resources in such a manner that performance can be evaluated in the mid-term review of that Plan.

Further, the lack of drive, consistency and accountability of the investment promotion effort (judged from an overall perspective) suggests that the Government should establish an investment policy and promotion coordination unit within a central ministry in order to support and monitor systematic investment promotion by the responsible agencies and ministries.

C. Summary of findings and policy recommendations

Botswana should establish a coherent, well-developed FDI strategy in line with its national development objectives as set out in Vision 2016. Sustained FDI into all sectors will be needed to help achieve these ambitious growth and diversification goals. This review of strategic perspectives recommends a number of remedial actions :

1. The drift in policy-making towards a view of FDI as a significant threat to the development of nationally owned business should cease. It is not borne out by current reality or international experience. The Government should lead a change in public thinking; “empowerment” is not a helpful term for the foreign investment climate in this regard. Weak development of local business is much more likely to reflect the speed of Botswana’s economic transformation and initial focus on the public sector than crowding out by FDI.

2. The Government is rightly concerned about supporting local entrepreneurship. National private investment must play a leading role. Moreover FDI contributes most to host country development when the national private sector is sufficiently advanced to create opportunities for mutually beneficial linkages. The Botswana private sector is not yet at that stage although foreign investors are aware that the Government wishes to see linkages developed wherever possible.

3. FDI is attracted by resources, markets or the prospect of efficiency gains. The following describe Botswana’s performance and prospects for attracting FDI:

- ◆ Mining (other than diamonds) and tourism, which attract resource-seeking FDI, have underperformed their potential;
- ◆ Manufacturing is strongly dependent on international market niches to attract FDI. Botswana appears to have underperformed its potential; it will need to upgrade its competitiveness, because it faces increasing competition for FDI from other locations with preferred-market-access arrangements.
- ◆ Telecommunications, utilities and transport services are important factors in increasing business competitiveness. The potential to attract FDI towards this goal has been underutilized because the privatization debate has been too narrowly focused.
- ◆ An important strategic step has been taken to attract FDI to Botswana as a base for regional financial and business services.

4. Key strategic measures required for Botswana to maximize FDI and benefit from it are human capital development, enhancing competitiveness and systematic investment promotion (see below). Education and skills development has lagged in Botswana for understandable reasons. It affects labour force trainability and productivity as well as local entrepreneurship development. This appears to be fully recognized, and a major catch-up effort is under way. One of the recommendations to ensure that this effort is more focused and better targeted to meet the needs of business development is that the private sector should be encouraged to play a proactive role in the area of education and training.

5. International competitiveness in the provision of business inputs will become more important in attracting market-seeking FDI, whether in manufacturing or in regional business and financial services (see 3 above). Three initiatives are recommended, aimed at making Botswana the “best in Africa”:

- ◆ Investment-led-competition policy that ensures that both public and private sector businesses face vigorous competition from new entrants, including foreign investors;
- ◆ Implementation of the privatization programme; and
- ◆ Benchmarking and monitoring of Botswana’s international competitiveness – as a tool for identifying policy actions where competitiveness slides back. The Ministry of Trade and Industry should lead these initiatives.

6. Systematic, sector-based investment promotion is needed, which recognizes that a good investment climate alone cannot attract FDI. Promotion is currently patchy and not developed to high and accountable standards. A promotion campaign is recommended for each sector with the following four elements:

- ◆ Calibrated policy and operational regime;
- ◆ Specialized analysis of the sector’s potential for FDI;
- ◆ Careful investor targeting; and
- ◆ Appropriate organization, budget and accountable targets.

7. These key strategic measures should be incorporated into the next National Development Plan and properly evaluated in the mid-term review. A central unit should be established to support and monitor the agencies and ministries that are responsible for investment promotion.

IV. CONCLUSIONS AND RECOMMENDATIONS

FDI has been an immensely important factor in Botswana's unprecedented economic transformation over the last 30 years and must surely play an important role in achieving the ambitious growth and diversification objectives of Vision 2016. FDI has always been welcomed and fairly treated, and has benefited from an excellent business climate. Yet, with policy towards FDI entry regressing, the future prospects for FDI are not encouraging. There is no coherent strategy to guide the formulation of wider policy measures to attract and benefit from FDI. And FDI promotion is not being pursued systematically across the board.

Sensitivities in Botswana to FDI need to be overcome. This review suggests that there is much less conflict between national business aspirations and FDI than is supposed in Government circles. What evidence there is suggests that FDI does not systematically crowd out national investors, and, indeed, that local business development is important so as to seize the linkage opportunities offered by FDI. A clearer assessment of the issues and careful design of policies can allay concerns. If this can be achieved, the way is then open to set out a much more proactive strategy and policies in order to attract more FDI and benefit from it.

Accordingly the principal findings and recommendations of this review are as follows.

Particular sensitivities towards FDI should be addressed. First, a new FDI law needs to be drawn up which recognizes the reality of the good treatment that has historically been accorded to foreign investors, yet affords appropriate protection to national investors in acutely sensitive areas. Thus the draft foreign investment code should not be implemented in its proposed form. Secondly, a separation of FDI from the sensitivities of economic migration should be achieved by adjustments in the residence and work permit system, rather than by FDI entry restrictions.

Improvements in the operating conditions for business, including FDI, are needed. In particular these include an improved work and residence permit system and a better market in land allocation. Some administrative functions are unacceptably slow. Industrial licensing should be simplified and speeded up.

Botswana does not have an FDI strategy; yet attracting FDI will become tougher as the investment climate in other countries in the region improves and becomes as good as that in Botswana. The Government should draw up an FDI strategy that systematically develops the factors that attract FDI and vigorously markets them. Elements of an FDI strategy should include the policy reforms identified above along with wider measures.

A greater drive for more competitive provision of business inputs is needed, including a move beyond the narrow focus in the privatization debate on ownership issues. For example, niches for market-seeking manufacturing FDI are being diluted, which increases the need for greater competitiveness in order to attract and retain FDI. Work on a competition law should be completed speedily and an independent enforcement agency established. The Government should implement the law effectively, once it is adopted.

Education and training for the needs of the private sector and local business development have lagged due to Botswana's rapid transformation. These are vital strategic factors in both attracting future FDI and benefiting from it.

FDI should be thought of as a complement to local enterprise development, and not as a threat. It can bring skills, expertise, and access to new technologies and new markets that can reinforce domestic enterprise promotion efforts. Therefore, promoting rapid national private sector growth is not only essential for its contribution to Botswana's growth and diversification, but also for maximizing the dynamic contribution that FDI can make. But foreign investors will not come if they envisage difficulties in replacing those who can no longer work because of HIV/AIDS with skilled foreigners in the absence of an adequately skilled workforce in Botswana.

The current haphazard promotion of FDI (which is in some respects crippled by the ambivalent attitude towards FDI) should shift towards more systematic investment promotion in each sector. Such promotion involves four elements: the prior implementation of competitive taxes and regulations (this review suggests that sectoral policy has become timid); careful assessment of investment potential; accurate targeting of investors (e.g. in some cases smaller regional investors may be more realistic targets than Fortune 500 companies); and adequately funded and organized marketing.

A comprehensive FDI strategy should be prepared for the next National Development Plan (from March 2003) and, where possible, it should contain performance targets. The mid-term review of the NDP is an established tool and it should be used to assess this performance in areas such as building competitiveness and promoting FDI.

The recommended FDI strategy and the new policy measures would entail more candid support for FDI by the Government, yet would not detract from its campaign for national business development. The Government will need to lead public opinion on these. It may find that the empowerment issue is not helpful in this regard, particularly with respect to promoting FDI.

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Annex

Survey of foreign affiliates in Botswana

Introduction

In the second half of 2001, UNCTAD and UNDP conducted a survey of foreign affiliates in Botswana to identify key investment determinants and strengths and weaknesses of the country's business environment, as perceived by foreign investors operating in Botswana. The survey was based on a mailed questionnaire and interviews with 29 small and medium-sized foreign affiliates, primarily in the manufacturing and services sectors. The survey response rate was around 50 per cent.

The survey did not include large foreign affiliates in mining, which account for three-quarters of FDI stock. Therefore, the survey results reflect the views of the small and medium-sized foreign investors.

I. Profile of surveyed companies

Manufacturing firms accounted for 10 of the 29 respondents. Three were garment manufacturers and the others included manufacturers of furniture, pipes and chemicals (including polishes and paper products). Nine respondents were retail and wholesale trading firms. Other services, including tourism, construction, publishing, health care, transport and financial services, accounted for another eight. One firm was in agriculture. The firms originated from such diverse economies as Germany, Liechtenstein, Norway, Singapore, South Africa, Sri Lanka, Taiwan Province of China, the United Kingdom, and Zimbabwe. Most of the respondent firms were wholly foreign owned (table A.1).⁴⁵

Table A. 1. Ownership structure of respondents

PERCENTAGE FOREIGN OWNERSHIP	NUMBER OF FIRMS
100	20
50 to 99	7
21 to 49	2
Total number of firms	29

Source: Government of Botswana, Ministry of Commerce and Industry (1998).

Most firms were small, with the majority employing fewer than 100 people, and one third of the total employing fewer than 50. Two firms employed over 1,000 people. Out of 26 firms that provided data on employment, manufacturing firms accounted for over 50 per cent of the jobs and the services sector accounted for almost the entire balance. Of the 19 firms reporting sales figures, manufacturing accounted for 12 per cent of total sales and services for 86 per cent.

The majority of respondent firms planned to increase production over the next three to four years, and only five firms had no plans for growth. The latter firms, comprising three manufacturers and two distributors, were small in terms of employment, with none employing more than 150 people.

⁴⁵ Defined as 50 per cent or more foreign-equity holding.

2. Imports and exports

a. Imports

The surveyed foreign affiliates imported around 60 per cent of their inputs. Six of the firms imported less than 20 per cent of inputs (including a furniture manufacturer, a trader and financial services companies), while 14 firms imported between 80 to 100 per cent of their inputs. In extreme cases, three garment manufacturers imported 95, 98 and 100 per cent of inputs; and a petroleum distribution affiliate imported 100 per cent. When asked if there had been a decrease in the use of imported inputs now, compared to five years ago, about 70 per cent of respondents reported no change. This implies that the possibility of sourcing inputs from local suppliers has not visibly improved.

b. Exports

Most of the surveyed firms, 20 out of 29, are not exporters. This produced a bias towards the domestic market in the responses concerning the importance of the domestic versus international market as a determinant of investment, as seen below. This bias was reinforced by the fact that 4 of the 9 exporting firms exported only a small proportion of their output. Notable exceptions in the sample were three garment manufacturers (which exported 15, 80 and 100 per cent of their total sales), a paper products company (90 per cent) and a pipe manufacturing company (50 per cent). The garment firm that exports its entire output did not release sales figures. The total exports of eight remaining exporters were \$25 million. Export markets for garment manufacturers included Canada, Europe, South Africa, the United Kingdom and the United States. Non-garment manufacturers exported mainly to other African markets, including Namibia, South Africa, Swaziland, Zambia and Zimbabwe.

3. Reasons for investing in Botswana.

Firms were asked to rank the degree to which various factors had influenced their decisions to invest in Botswana. A ranking of 1 denoted "unimportant", while 4 denoted "very important" (figure A.1). Political and economic stability were clearly the most important of all the factors, gaining the highest mean ranking (over 3.5) and the lowest standard deviation (indicating that most firms shared similar opinions). Other features that were attractive (mean score of over 2) included, in decreasing order of importance: growth of the local market, investment profitability; size of the local market; quality of the physical infrastructure; tax incentives; the regulatory and legal framework for FDI; and other, non-tax investment incentives. More than 80 per cent of the respondent firms considered political and economic stability, profitability of investment, size of the local market and growth of the local market as important or very important (figure A.2).

The high ranking of the size and growth of the local market and the low importance of access to global markets is a somewhat surprising result, given the relatively small size of the Botswana domestic market. As explained earlier, it is due to the fact that of the 23 firms for which growth of the local market was "very important" or "important", only five were exporters and the remaining 18 firms were in non-tradable services or distributive trade. By comparison, of the 5 firms for which growth of the local market was "unimportant", three were exporters, one freight forwarder and one in tourism.

There was more variance of opinion among firms on the importance of investment incentives, as reflected in the higher standard deviations for answers to this question: 11 firms said that tax incentives were "very important", compared to 5 which said they were "unimportant". Of the group for which tax incentives were important, most were relatively large employers, especially in comparison to the group for which taxes were unimportant (4 out of 5 of whom employed 30 or fewer people.) Similarly with respect to non-tax incentives, which 10 firms declared "very important" and 7 firms "unimportant", the 10 firms tended to be reasonably large employers, while the 7 were considerably smaller. Both tax and non-tax incentives were more likely to be important to firms that exported, compared to non-exporting firms; of the small number of exporting firms in the total surveyed (9 out of 29), 5 stated that tax incentives were very important, and 4 of those 5 also stated that non-tax incentives were very important.

Figure A. I. Factors influencing companies' decisions to invest in Botswana
(Rating from 1 = "unimportant" to 4= "very important")

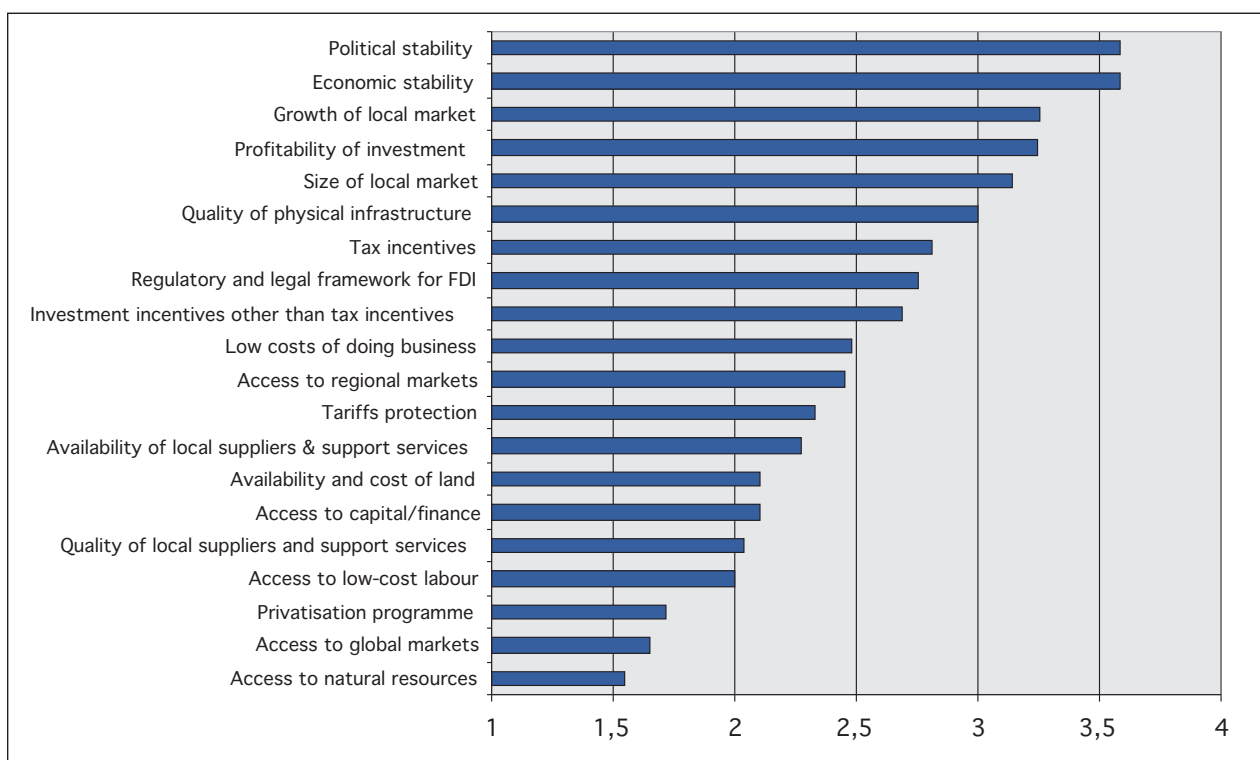
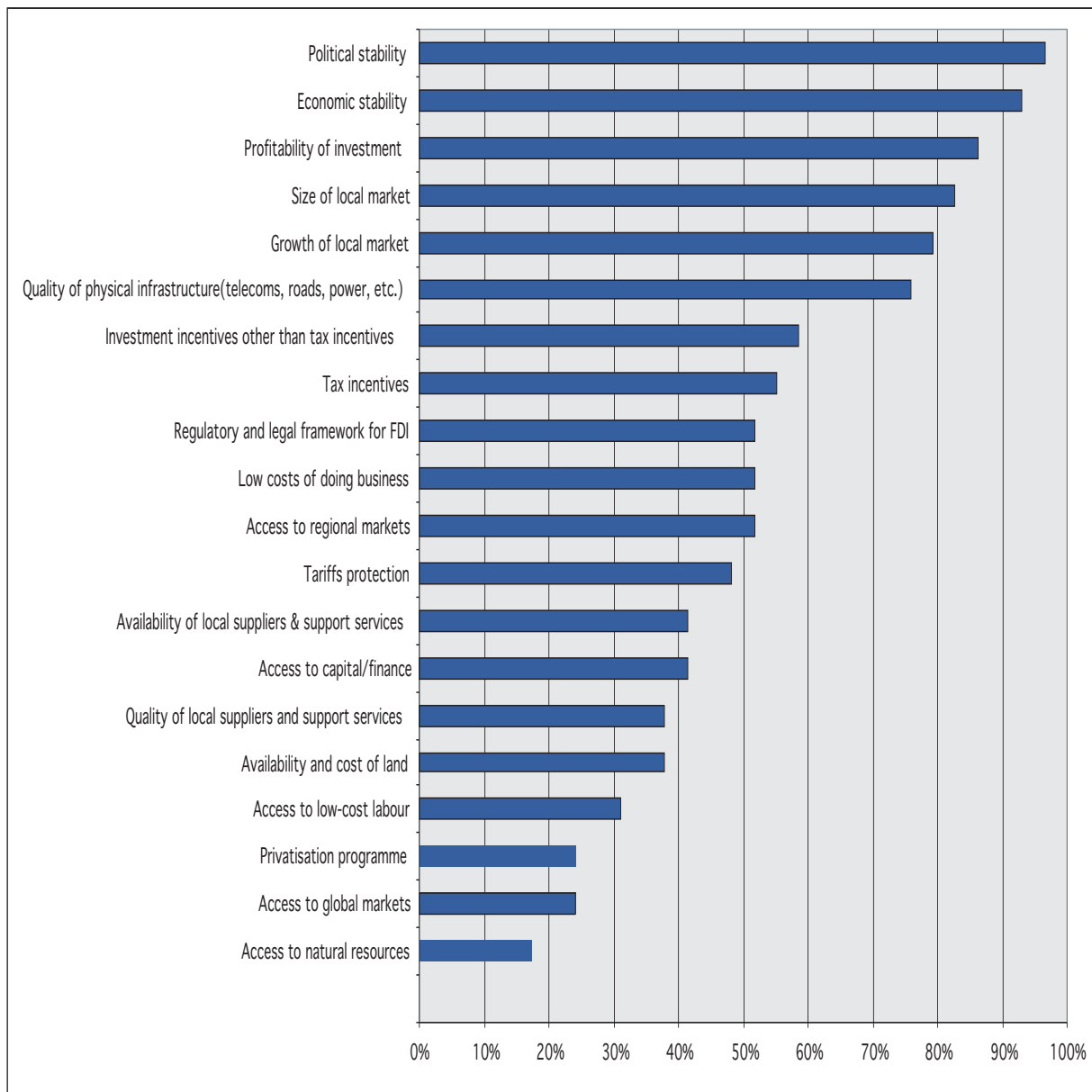


Figure A. 2. Factors influencing companies' decisions to invest in Botswana
 (Percentage of firms citing "important" or "very important" for individual factors)



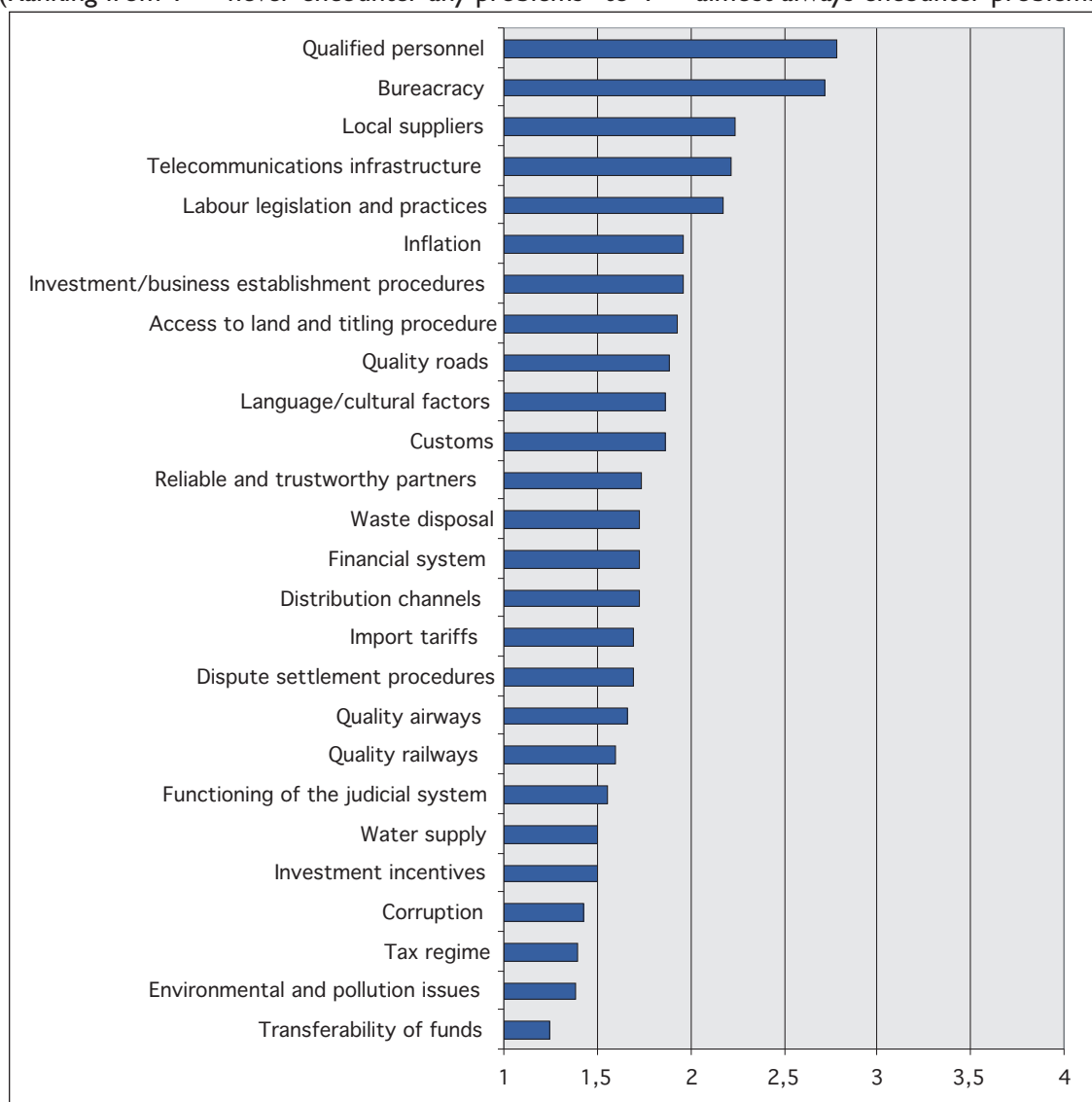
4. Business environment

When survey respondents were asked to indicate the frequency with which they encountered problems in their daily business operations, no problems were ranked on average as high as 3 ("frequently a problem") or 4 ("always a problem"). Only five difficulties ranked on average above the level of 2 ("occasionally a problem"). These difficulties included the following, in descending order: lack of qualified personnel; bureaucracy; problems with local suppliers; problems with telecommunications infrastructure; and labour legislation and practices (figure A.3).

However, although the arithmetic mean scores for the five most frequently occurring problems were never above 2, at the level of the individual firm, a number of firms did claim that these five problems occurred "frequently" (hence scoring 3) or even "almost always" (scoring 4). Depending on the particular problem, between 8 and 15 firms out of the 29 gave scores of 3 or 4. The sole tourism respondent answered that every one of the five top problems

Figure A. 3. Mean rankings for areas in which foreign companies encounter difficulties in their daily business operations

(Ranking from 1 = "never encounter any problems" to 4 = "almost always encounter problems")



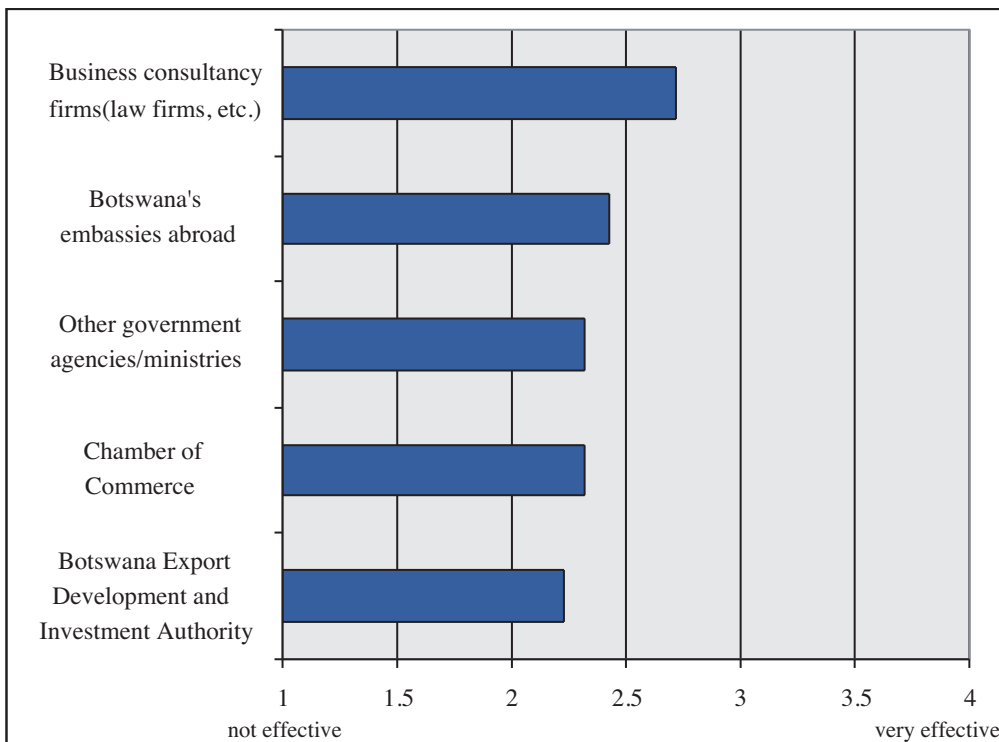
described above occurred "almost always"; while two garment manufacturers employing 1,550 people reported "almost always" having problems with respect to both qualified personnel and bureaucracy. The five firms that did not plan to increase production over the next 3 to 4 years were among the group that reported frequent problems: all of them with bureaucracy and lack of qualified personnel, three with the telecommunications system, and two with local suppliers.

However, the experiences of these particular firms notwithstanding, because the majority of firms surveyed either "never" or only "occasionally" experienced these problems, the mean score was low. It is also notable that an extremely small proportion of those surveyed reported having "frequent" difficulties with dispute settlement procedures (3 firms), corruption (2 firms), or the functioning of the judicial system (1 firm). No firms reported having difficulties "almost always" in these areas.

5. Advisory and support institutions

Most of the institutions providing advice and support to foreign investors in Botswana were described as being moderately effective, with none described as either "extremely" or "not" effective. Business consultancy firms were ranked most highly, followed by Botswana's embassies abroad, other government agencies and ministries, the Chamber of Commerce, and finally, the "board of development" and "investment authority". Opinions were commonly shared, with low variance in all responses, (see figure A.4).

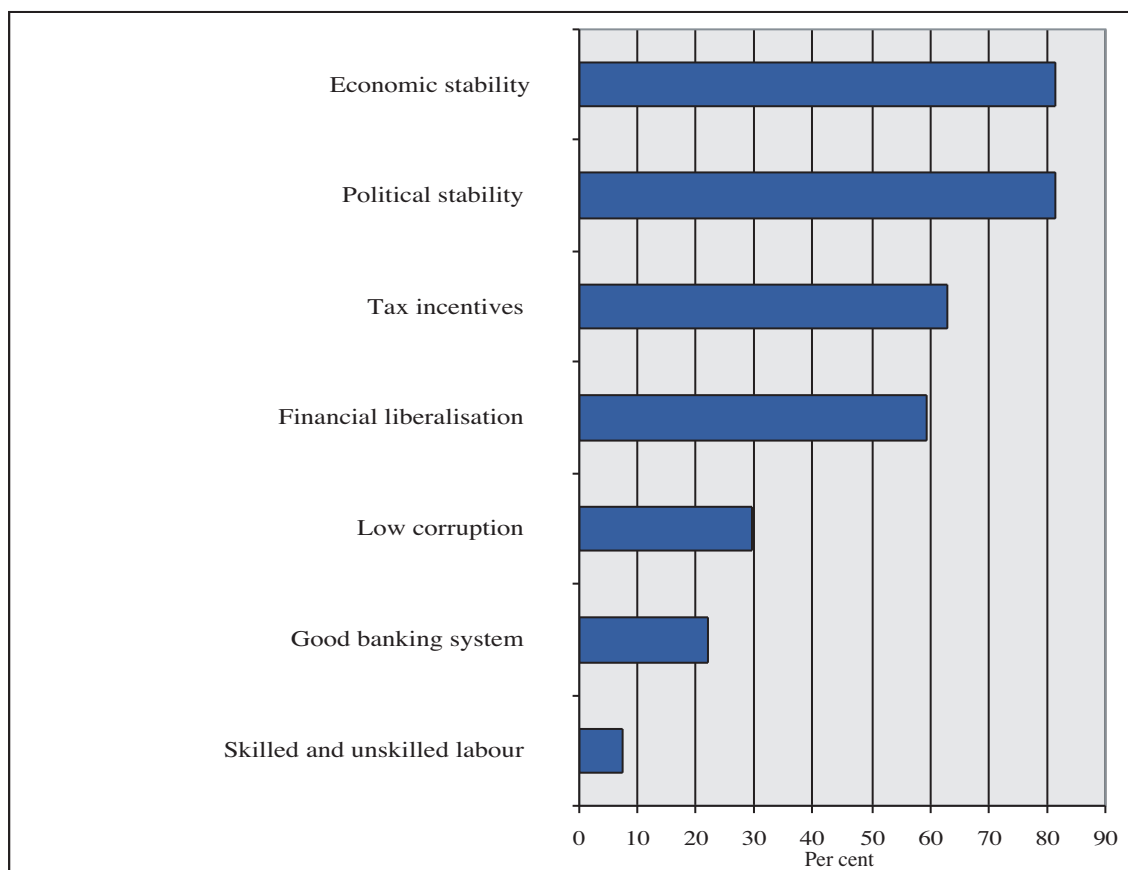
Figure A. 4. Effectiveness of institutions providing information and support to foreign investors
(Rating from 1 = "not effective" to 4 = "very effective")



6. Strengths and weaknesses of the business environment

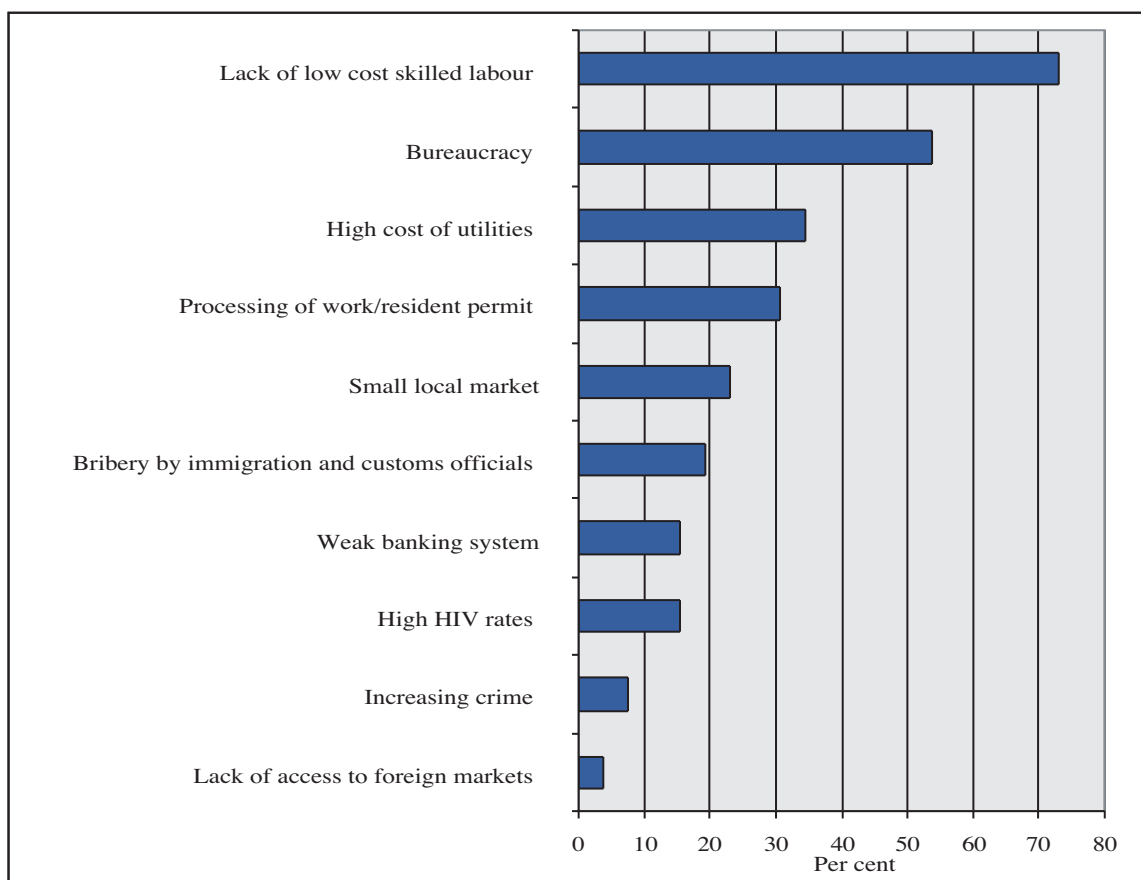
Asked their view of the five *strongest* elements of Botswana's business environment, (this open-ended question has the benefit of allowing firms to answer spontaneously rather than choosing among suggested responses), over 80 per cent of respondents identified Botswana's economic and political stability as being among Botswana's five greatest strengths. Typically, "stability" was on the top of the list for most firms, and the few firms that did not give it first priority did list it among the first three priorities. The next most frequently cited strengths were Botswana's tax incentives (cited by over 60 per cent of respondents) and its liberal financial environment (cited by almost 60 per cent). Other strengths frequently cited were Botswana's low levels of corruption (30 per cent), and its banking system (22 per cent) (see figure A.5).

Figure A. 5. “What in your view are the five strongest elements of Botswana’s business environment?”



When firms were asked open-ended questions about Botswana's weakest aspects, almost 80 per cent of respondents spontaneously cited difficulties with obtaining low-cost, skilled labour. Excessive bureaucracy was the second most frequently cited problem, reported by over 50 per cent of respondents. More than 35 per cent of respondents cited problems with the high costs of Botswana's utilities, while around 30 per cent complained of problems with processing work or residence permits. Other problems cited included Botswana's small local market; corruption by immigration and customs officials and weaknesses in the banking system (cited by 15 per cent of respondents), (see figure A.6).

Figure A. 6. “What in your view are the five weakest aspects of Botswana’s business environment?”



7. Suggested policy improvements

Finally, the survey asked respondents to identify measures they thought the Government could take in support of business and investment. Two key areas that were most frequently identified were:

- ◆ Education and training of the Botswana labour force; and
- ◆ Work and residency permits for foreign workers.

The two problems are often interrelated, in that the lack of local skills means that firms have a greater need for bringing in skilled employees from abroad. Problems cited included the length of time it takes to process work and residence permits and that assessment of foreign employee permits is made without reference to the needs or opinions of local employers. One firm claimed that easing restrictions on work permits would lead to increased business and employment; another claimed that if the situation did not improve, it would be forced to relocate its sales and marketing office outside Botswana. With respect to local employees, respondents complained that the skills training currently available in Botswana is not up to industry standards. They suggested training schemes be made more industry-focused, and suggested a system of grants or tax incentives to encourage further training of local workers.

Box A.1. provides quotations from companies' comments on these two issues

Box A.1. Respondents' comments and recommendations

On education and training

- ◆ "Little training available is not up to industry standards"
- ◆ "Grants to employers for training costs"?
- ◆ "Must improve"
- ◆ "Requires to be more focused"
- ◆ "Encourage more training through further tax incentives"

On work and residence permits for foreign employees

- ◆ "If problems continue, we will be the last tourism enterprise of any size, who will have to relocate our sales marketing office outside Botswana"
- ◆ "Should be made flexible"
- ◆ "Very slow process"
- ◆ "Need for faster processing"
- ◆ "Allow established companies to employ experts"
- ◆ "Needs a lot of improvement"
- ◆ "Must improve a lot"
- ◆ "Delay in obtaining work/resident permits"
- ◆ "Revised completely, but being selective"
- ◆ "One stop shop approach"
- ◆ "Should be sorted out quickly"
- ◆ "More work permits will increase business and employment"
- ◆ "Need to be streamlined"
- ◆ "Assessment of foreign employees permits should involve reference to local employers opinions"
- ◆ "Speed processing"
- ◆ "Needs improvement"

QUESTIONNAIRE

SURVEY OF FOREIGN AFFILIATES IN BOTSWANA

Purpose: To solicit views of affiliates of foreign companies based in Botswana as to the determinants of their investment decisions in Botswana, strengths and weaknesses of country's business environment and possible policy measures they believe would support business and investment.

Name of company:	Address:
Year of establishment in Botswana.	
Name of respondent:	Parent company's name:
Position:	Headquarters (country):
Tel:	Fax:
	E-mail:
Main business activity:	Total number of employees in Botswana. Total sales in 2000 or latest year: (US\$)

A. Company profile

1. Ownership structure (please circle correct response):

- | | |
|------------------------------|-------------------------------|
| (a) 100% foreign-owned | (b) 50-99% foreign-owned |
| (c) 21% to 49% foreign-owned | (d) 20% or less foreign-owned |

2. If your company exports,

- (a) What are the principal export products?
 (b) What is the share of exports in total sales?
 (c) Which are the major export markets? Please complete the table below.

Export market (country)	Share of the country in total exports
1.	
2.	
3.	

3. What is your market share in the principal industry that you operate in Botswana? Please circle correct response:

- (a) 60% and above (b) 40 - 59% (c) 20 - 39% (d) 10 - 19% (e) less than 10%

**4. (a) What percentage of your company's inputs is imported?.....%.
 What was it 5 years ago (or when first established)?**

Lower..... Same Higher

(b) If there was a decrease in the use of imported inputs, was this done through
 Purchase of local inputsIncreased firm-level production of inputsBoth.....

5. What are your company's production plans in Botswana for the next 3-4 years (2001-2004)? Please mark with an "X" one of the options below that best describes your plans?

Increase production	Decrease production	No change	Pull out
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B. Why did your company invest in Botswana?

6. Please rank on a scale from 1 (unimportant) to 4 (very important) the significance of each of the factors in influencing your company's decision to invest in Botswana. Mark your answer with an "X".

Factors influencing your investment in Botswana	Importance of this factor			
	1 Unimportant	2 Somewhat important	3 Important	4 Very important
Access to capital / finance				
Access to global markets				
Access to low-cost skilled labour				
Access to natural resources				
Access to regional markets				
Availability and cost of land				
Availability of local suppliers & support services				
Economic stability				
Growth of local market				
Investment incentives other than tax incentives				
Low costs of doing business				
Privatization programme				
Political stability				
Profitability of investment				
Quality of local suppliers and support services				
Quality of physical infrastructure (telecom, roads, power, etc.)				
Regulatory and legal framework for FDI				
Size of local market				
Tariff protection				
Tax incentives				
Other factors (please specify)				

If you wish, please elaborate on any of the above points on a separate page.

C. Business environment

7. The objective is to identify areas of difficulties that you encounter in your daily business operations. Please indicate the frequency with which you encounter problems in each of the areas on a scale from 1 (never encounter problems in this area) to 4 (almost always encounter problems in this area).

Area where your company encounters difficulties	1 Never	2 Occasionally	3 Frequently	4 Almost always
Access to land and titling procedures				
Bureaucracy				
Corruption				
Customs				
Dispute settlement procedures				
Distribution channels				
Environmental and pollution issues				
Financial system				
Functioning of the judicial system				
Import tariffs				
Inflation				
Investment incentives				
Investment/business establishment procedures				
Labour legislation and practices				
Language/cultural factors				
Local suppliers				
Qualified personnel				
Quality of transport services and infrastructure				
a. Roads				
b. Railways				
c. Air transport				
Reliable and trustworthy local partners				
Tax regime				
Telecommunications infrastructure				
Transferability of funds				
Waste disposal				
Water supply				

Botswana's investment promotion	
Business establishment procedures	
Corruption	
Customs procedures	
Education and training	
Environmental regulations	
FDI regime	
Foreign exchange regime	
Investment incentives	
Investment procedures	
Investor rights	
Land tenure policy	
Macroeconomic policies	
Privatization programme	
Tariffs on imported components	
Tax regime	
Technology policy	
Telecommunications	
Transportation services	
Work/residence permits for foreign employees	
Other (please specify)	

If you wish, please elaborate on any of the above points on a separate page.

8. What is your company's experience as regards the effectiveness of the following institutions in providing information and support to foreign investors. Rate from 0 (not effective) to 4 (very effective).

Botswana's institutions	1 Not effective	2 Moderately effective	3 Effective	4 Very effective
Botswana Development and Investment Authority				
Other Government agencies/ministries				
Chamber of Commerce				
Botswana's embassies abroad				
Business consultancy firms (law firms, etc.)				

9. What in your view are the five strongest elements of Botswana's business environment?

- a. _____
- b. _____
- c. _____
- d. _____
- e. _____

10. What in your view are the five weakest aspects of Botswana's business environment?

- a. _____
- b. _____
- c. _____
- d. _____
- e. _____

D. Suggested policy improvements

11. Which measures do you think the Government could take in support of business and investment?

Possible areas of action	Measures required, if any
Botswana's access to foreign markets	
Botswana's investment promotion	
Business establishment procedures	
Corruption	
Customs procedures	
Education and training	
Environmental regulations	
FDI regime	
Foreign exchange regime	
Investment incentives	
Investment procedures	
Investor rights	
Land tenure policy	
Macroeconomic policies	
Privatization programme	
Tariffs on imported components	
Tax regime	
Technology policy	
Telecommunications	
Transportation services	
Work/residence permits for foreign employees	
Other (please specify)	

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