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RATIONALIZATION OF INVESTMENT POLICIES FOR AFRICA'S DEVELOPMENT IN THE LIGHT OF EXPERIENCE OF BOTSWANA

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I. INTRODUCTION:

The objectives and strategy behind Botswana's development since independence have been greatly influenced by the state and conditions existing in the economy at the time of independence. At independence in 1966, Botswana, with a population of a little over half a million, was considered one of the poorest countries in the world, with an almost complete dependence on the cattle industry and with the majority of the population involved in traditional subsistence agriculture. The country had virtually no alternative sources of income, employment and foreign exchange and the prospect was one of continued poverty and total dependence on British government grant-in-aid to balance its recurrent expenditure, not to talk of development expenditure. Social and economic infrastructure was barely developed and about 30% of the labour force provided a reservoir of cheap labour for the South African mines. However, during the quarter century to 1991 the economy showed a remarkable growth and buoyancy never experienced anywhere in Africa. Real per Capita income increased from P578 in 1966 to P4115 in 1988/89 implying an annual growth rate of 9.3% and the economy experienced a structural change from dependence on agriculture (39% in 1966) to one on mining (51% in 1989/90). In the social sectors (Education, Health, Roads and Water Supply) there have been commendable improvements, with school enrolment currently standing at 90% of children of primary school age and 30% of children of secondary school age; 80% of rural villages have access to potable water and 85% of the rural population is within 15km of a health facility (NDP 7). Employment in the formal sector increased from 41,300 in 1972 to 224,000 in 1992 or at an annual rate of growth of 8.8%. The improvements in the socio-economic circumstances of Botswana have been made possible by a number of factors, significant among which are a series of national development plans (of which the current one is the seventh instalment) to guide government policy, discovery and exploitation of mineral resources, especially diamonds, and economic management which has received commendable mention in various quarters.

As Botswana enters the decade of the nineties with the inauguration of NDP7, recent developments and future outlook in the external sector with their implications for government fiscal position indicate that if the planning objectives of rapid economic growth, economic independence, social justice and sustained development are to be achieved, there is need for a change in the strategies and policies which have promoted these objectives in the past. For example to secure a continuation of rapid economic growth and economic independence there is need to concentrate growth on sectors other than mining and cattle which have thus far been the sources of growth in the economy. Experience elsewhere in the LDC's has demonstrated that sustainable growth and development can be achieved in the long run when the economy is dependent on several mutually supportive sectors rather than on one or two sectors as is the case in Botswana. Furthermore the objective of social justice has been achieved in the past mainly through the distribution of social and economic services, namely, health care, potable water, primary education, improved communication and transport services. Despite impressive gains in formal sector employment, incomes continue to be low and unemployment is widespread. Thus to promote the objective of social justice in future, emphasis will have to be placed or creating income earning opportunities both in the rural and urban areas. In short, the promotion of all the four objectives of planning devolves on the diversification of the economy and promotion of new sources of growth. It is within this context that a clearly defined investment policy and promotion becomes very compelling.

II. INVESTORS' STRATEGIC CONSIDERATIONS AND PERCEPTION OF RISK:

The decision of investors to commit their resources to investment in a given country is influenced by their perception of the risk in that country as well as certain strategic considerations. Investors' assessment of the political risk in the country of location is perhaps the most important factor influencing their decisions. No investor would want to invest his money in a politically unstable country for fear of intermittent interruptions in production activities as a result of strikes or of losing the investment altogether as a result of civil strife. Thus a stable political atmosphere is important in attracting foreign investment. Furthermore investors are attracted to a given country in the expectation of earning a reasonable return on their investment so that any factor which affects their expected rate of return is likely to influence his decision. Thus such strategic considerations as access to markets (domestic, regional or others in which the host country has preferential access), competitively priced natural resources and existence of low cost production base for exports etc are important influences on the decision to invest. In addition to these considerations, investors are interested in operating in an enabling macro-economic environment where there are no or fewer exchange controls, no constraining regulatory framework, no crowding out of the private sector either in terms manpower supplies or investment funds and where there is a general macro-economic stability. Furthermore, investors also consider what incentives are available in a given country since these are also likely to impinge on their profits. This is particularly important in an atmosphere where the competition to attract investment is high and all sorts of investment incentives are being offered by other countries. Thus the rationalization of investment policies requires a correct judgement on the part of the host country of these factors which influence investor decisions and ability to create the necessary environment, design the appropriate investment and other policies to accommodate these factors. It is against this background that the experience of Botswana will be judged in the rest of the paper.

III. <u>THE EXPERIENCE OF BOTSWANA</u>:

Botswana's investment promotion policies may be grouped under four broad categories, namely. Enabling Environment, Macro-economic Stability and Sound Macro-economic Management, Regulatory Regime and Incentive Schemes. Each of these will be discussed in turn.

1. <u>Enabling Environment</u>:

Political Stability: Unlike a host of other African countries, Botswana has enjoyed a very stable political atmosphere since independence and this, to some extent, has served her well, in terms of relocation of industries, in the midst of political turmoil in RSA and uncertainties, both economic and political, in Zimbabwe. This is perhaps due to the government's ability to translate the benefits of rapid economic growth of the past quarter of a century into widespread distribution of social services and economic opportunities in the form of increased formal sector employment. As we have already observed above, despite this, incomes continue to be low and unemployment widespread. With widespread primary education and increasing urbanization, this stability has begun to show signs of weakness and it is a moot point as to whether this stability will be sustainable in the years ahead. It will depend on the delicate balance between promoting the employment objective and keeping income disparities within tolerable limits.

Role of the Private Sector: Although Botswana's economy has been characterized by planning in the form of Public Sector Investment Programing, the important role of the private sector in the development process ha, never been in doubt.

In the first six National Development Plans, the government had occupied central stage in channelling resources generated by the Mining Sector into the development mainly of the rural sector and social and economic infrastructure. This, as indicated above, has been necessitated by the poor state of the Botswana economy at the time of independence.

At the time of formulating NDP7, it had become clear, as we have alrady pointed out above, that the objectives of planning could only be achieved through the policy of diversification. In recognition of this the new policy initiatives embodied in the NDP7 put emphasis on private sector activities to:

- "achieve economic growth through diversification;
- create income earning opportunities;
- create employment for a larger part of the labour force; and
- provide principal source of government revenue" (NDP7).

The plan also cearly defined the role of the public sector as supporting the private sector to play the above roles, pursuing a prudent fiscal policy by ensuring that recurrent expenditure arising from government development expenditure does not become unsustainable; government was further to assume major responsibility for training the required technical and professional manpower to support the development effort. With such clearly defined roles of the private and public sectors, and with such a complementary relationship between the two, it is easy to avoid the predominant one, in this case the public sector, overcrowding the other in any particular respect. Again on the initiative of the Botswana Confederation of Commerce, Industry and Manpower (BOCCIM), a body which represents the interest of the private sector, a mechanism for dialogue has been established between the two sectors since 1990. Since then three conferences organized by BOCCIM have discussed problems faced by the private sector and recommendations emanating from these discussions have received serious government attention.

Fiscal Prudence: Another aspect of the enabling environment relates to the promotion of fiscal prudence on the part of the government. Between 1983 and 1991 the government has consistently incurred budgetary surplus which has even enabled it, through the Public Debt Service Fund (PDSF), to provide the financial resoruces required by the parastatals. Thus the pursuance of prudent fiscal policy has helped avoid a situation where the private sector is overcrowed with regard to borrowing from the domestic banking sector. Also through careful planning and allocation of manpower resources, the government has avoided unduly overstarving the private sector of badly needed supplies of technical and professional manpower.

Market Access: Owing to the small size of the domestic market, industries that will have to be established in response to the diversification policy have to be export oriented. Luckily Botswana's access to foreign markets is unhindered mainly because of the numerous international agreements to which Botswana is a party. its membership of the Southern African Customs Union (SACU) allows it free access to the markets in RSA, Lesotho, Swaziland and Namibia; again through the Lome Convention to which Botswana is a signatory, products of Botswana, like those of the 65 other LDC's who are signatories to the Convention, are admitted free of tariffs into the 12 member states of the EC; the only exceptions are a few commodities falling under the EC's Common Agricultural Policy. Botswana also has trade agreements with Malawi and Zimbabwe which allow free access of some commodities into these countries.

During the past decade "non traditional" exports (i.e. excluding diamonds, beef and copper nickel) increased by over 10% in real terms but much of this increase, especially in the textile and clothing sectors, was stimulated by exports to Zimbabwe owning to the overvaluation of the Zimbabwe dollar. When the Zimbabwe currency was devalued in 1991 as part of the the structural adjustment package, the clothing industry in Botswana virtually collapsed with consequent retrenchment in the sector. Despite Botswana's access to foreign markets, there are fears about the ability of the export-oriented industries to withstand competition from those in the neighbouring and other countries vying for internationally mobile capital.

2. Macro Economic Stability and Sound Macro Economic Management:

In addition to creating an enabling environment, the government has sought to maintain a long term macro economic stability in which private enterprise economy can thrive. The goals of government macro-economic policies are external balance, internal balance, price stability and efficient resource allocation.

External Balance: To achieve external balance, the government attempts to strike a balance between the demand for foreign exchange (for current and capital accounts transactions and building up foreign exchange reserves) and supply of foreign exchange (from export earnings, long term capital inflows, short term overseas borrowing and drawing down reserves). This has been achieved by controlling expenditure on imports and building up reserves in a period of export boom and gradually drawing down reserves to cover import expenditure when it can no longer be sustained by inflow of external resources. By taking a long term view of this balance, short term balance of payment crises and consequent constraint on growth of GDP have been avoided. The success of this exercise in the long term is manifested in the accumulation of large foreign exchange reserves which stood at P8.4 billion (US$3.3 bill.) at the end of 1992.

Internal Balance: The achievement of internal balance involves striking a balance between demand for resources in the economy and their availability at stable prices. This avoids too low an internal demand, leading to excess productive capacity with consequent loss to the economy and too high a demand, also resulting in bottlenecks and creating inefficiency and inflation. Avoidance of the latter is particularly essential since, given the openness of the Botswana economy (ratio of exports plus imports to GDP is 120%), any frustrated domestic demand translates into import demand and undermines the external balance. The successful achievement of internal balance is reflected in part by the consistent surpluses in the government budget since 1983 and the judicious application of credit policy to regulate private sector demand.

Price Stability: Despite the successes achieved in maintaining external and internal balances, inflation continues to be a serious problem in the economy. The need to contain inflation within reasonable limits arises from its adverse effects on income distribution, resource allocation and incentives for savings and hence investment. Levels of inflation in the Botswana economy are influenced to a considerable extent by inflation in RSA which is Botswana's principal source of imports. Government has sought to use exchange rate policy (revaluation) to offset imported inflation but, to the extent that revaluation weakens the competitive edge of non traditional export producers, it has become necessary to adjust the exchange rate upwards or downwards to achieve the desired trade-off between inflation and competitiveness.

Resource Allocation: Resource allocation between the public and the private sectors, consumption and investment, different sectors of the economy etc constitutes a serious policy concern. To illustrate with resource allocation between the public and private sectors, it is clear that if public expenditure is expanded too rapidly in the short run, the consequent pre-emption of resources would crowd out the private sector especially with regard to its skilled manpower requirements. In the long run, with the predicted tapering off of mineral revenues which have been the bulwark of government revenue, the government may be forced to resort to the imposition of higher taxes on other sectors of the economy. This could affect growth adversely and reduce the long term revenue earning potential of the economy. Thus there is need to strike the correct balance in resource allocation between the private and public sectors. The principal mechanism which the government has used to effect such balances in resource allocation is the development expenditure ceilings in the national development plans.

Liberal Foreign Exchange Control Regime: The government has maintained a liberal foreign exchange control regime since 1976 when Botswana introduced her own currency, the Pula. In this regime, minimal exchange control has been applied to current account transactions whereas the exchange control that has been imposed on capital transactions has only been necessary to avoid destabilizing or speculative movements while allowing for repatriation of profits. This has been made possible by the foreign exchange reserves accumulated over the years. The government intends to maintain this regime under NDP7 since it sees it "as an essential ingredient in fostering healthy private sector investment and growth" (NDP7 Macro outline pg.25).

3. <u>Incentives Schemes:</u>

Since the beginning of the 80's the government has introduced a number of incentive schemes to encourage private sector investment, both domestic and foreign.

They include the following:

(a). **The Financial Assistance Policy:** Introduced in May 1982, the FAP is the most comprehensive incentive scheme in place so far.

Its objectives are to:

* address the unemployment problem by creating sustainable employment for unskilled labour;

* diversify the economy away from the mining and cattle industries into other sectors of the economy by promoting import substituting and export - oriented industries

and

* providing skills to citizen workers through training.

The Scheme covers three categories of enterprises.

* small scale projects with a fixed capital investment of less than P25,000 and restricted to citizen only and assistance takes the form of grants;

* medium sccale projects with fixed capital investment between P25,001 and P90,000 and

* large scale projects with fixed capital investment exceeding P90,000;

The last two are open to both citizens and non citizens alike and assistance to them come in two forms.

__Case by Case Financial Assistance (CFA):__

Here assistance is in the form of grants which are part of taxable income. Eligible firms must show an economic rate of return of no less than 6% per annum. Assistance is provided in the form of initial capital grant, unskilled labour grant, sales augmentation grant and training grant covering the first five years of operation as follows:

Initial Capital Grant: A grant of P1000 per job created is paid to non citizen and joint venture companies and P1500 per job created to wholly citizen owned companies. This grant, based on projections submitted by the company to the FAP Committee, is paid before the project starts operation and is supposed to supplement borrowed and equity capital supplied by the owners of the company. The grant takes the form of a bank account from which the company may draw to purchase part of its fixed equipment rather than in the form of cash.

Unskilled Labour Grant: This takes the form of an 80%, 60%, 40% and 20% reimbursements of unskilled labour wage bill in the first two, third, fourth and fifth years of operation respectively. The grant is supposed to compensate companies for the low productivity of unskilled labour in the expectation that by the end of the fifth year productivity will have increased sufficiently to render the grant unnecessary and make the company sufficiently competitive vis-a-vis its foreign counterparts.

Sales Augmentation Grant: This grant takes the form of 8%of sales revenue in the first two years and 6%, 4% and 2% of sales revenue in subsequent years till the end of the fifth year at which time it expires. The idea here is, in part, to compensate companies for high cost of utilities, land, construction and transportation in Botswana and in part as compensation for exporters for the high cost of inland transportation to RSA and for the high wharfage charges assessed.

Traning Grant: A reimbursement of 50% of training costs during the first 5 years provided training is offered by an institution recognized by the Ministry of Education. The upper limit of the cost per trainee per year is set at P2500.

<u>Automatic Financial Assistance (AFA)</u>

This form of grant is in the form of reimbursements and cover tax holiday and training.

Tax Holiday: The level of tax holiday is geared to location to promote industrial dispersion; for companies in urban and peri-urban locations, tax reimbursement of 100% for years 1 and 2 and 75%, 50% and 25% in the 3rd, 4th and 5th years is granted. For companies in remoter parts of the country, 100% tax reimbursement for years 1, 2 and 3, 75% and 50% tax reimbursements for years 4 and 5.

Training Grants: Under this package, companies are offered training and unskilled labour grants similar to those enjoyed under CFA.

<u>ASSESSMENT OF FAP</u>:

Provisions in the FAP package have been severely criticised in a recent paper on Botswana's industrial policy by the World Bank (Botswana: Opportunities for Industrial Development June 1992). With regard to small scale industries, it is pointed out that although a 1988 study of

747 small scale FAP projects approved between 1982 and 1988 hints of a probable 50% rate of failure, one could live with this as a commendable achievement "among entrepreneurs with little or no prior business experience and a work force with minimal wage -earning experience" (pg. 138).

Under the OFA pacakage only the training grant is considered to have any merit, given the acute shortage of skilled workers. The report dismisses recent suggestions that the training grant be increased to cover 100% of off-the-job training costs and extended to on-the-job training as well, on the grounds that:

i. it is only when companies are encouraged to bear an increasing proportion of off-the-job training costs that training would be limited to cost effective ones

and

ii. inclusion of on-the-job training would open room for dubious claims.

The capital grant is critized on the grounds that it holds a great potential for abuse, fraud and misrepresentation which could occur through overinvoicing of capital equipment (since prospective suppliers are located outside Botswana) or shipment of lesser value of machinery than that indicated on the invoice.

With regard to the unskilled labour grant, the presumption that labour productivity would become competitive within 5 years of operation of the company is questioned on the basis of experience in the manufacturing sector elsewhere. This is particularly so in Botswana where labour productivity in the clothing industry is believed to be 1/4 of that in South-EAst Asia and less than ½ of that in RSA and Zimbabwe.

In the case of the sales augmentation grant, it is argued that except perhaps the cost of land, the disadvantages that the incentive is supposed to compensate for, are likely to persist after the 5 year period, making the effectiveness of the incentive rather limited. For example construction costs are reflected in higher rentals on industrial buildings far beyond the expiry period of the incentive.

In place of the tax holiday, the report recommends a low, say 15%, corporate tax indefinitely since a reversion to the current 40% corporate tax after the first five years is likely to render companies uncompetitive vis-a-vis their counterparts in, say, Mauritius who enjoy 15% corporate tax. The tax holiday arrangement carries the risk of companies migrating elsewhere after the 5 years when they can no longer hold on their own in the competition for markets, and this, of course, is much easier for labour intensive industries.

Finally the report questions the entire bias of FAP towards labour intensive industries on the grounds that the experience of many manufacturers suggest that the productivity threshold that needs to be crossed within five years to render companies competitive is unrealistic; thus by offering such a battery of subsidies to companies the FAP may be locking them into activities in which Botswana has inherent comparative disadvantage.

(b). <u>Selebi-Phikwe Regional Development Program:</u>

The Selebi-Phikwe Regional Development Programme (SPRDP) was initiated in 1988 to induce investors to invest in the

Selebi-Phikwe Township in order to reduce dependence on the ailing copper-nickel mining enterprise by diversifying into other productive activities. The programme was further enhanced in 1989 by the introduction of a special incentive package which in addition to the FAP component offers:

* a nominal corporate tax of 15% for the first 20 years of the project life;

* an exemption from withholding tax on dividends paid for the first 10 years of the project;

To qualify for the package, investors were required to:

* locate in the Selebi-Phikwe area;

* export 100% of their output outside the SADC and SACU regions;

* employ no less than 400 Botswana during the first two years of project life and maintain employment at or above that figure thereafter and

* the porject must be promoted by an established international company in existence for at least 10 years, investing at least 25% of the project combined fixed and permanent working capital as equity.

Anecdotal evidence seems to suggest that the SRPDP has succeeded in attracting foreign investment into the region and the question arises as to why the "organisational features of SPRDP that have enabled it to succeed cannot serve as a model for national investment promotion strategy". (World Bank; Opportunities for Industrial Development in Botswana.)

c. **Local Preference Scheme:**

The local preference scheme provides incentives for Botswana manufacturers who sell to the government, local authorities and parastatals and the incentive is in the form of a price advantage over goods of foreign origin. The condition for eligibility for the price advantage is that products should have at least 40% local content. The objective of the scheme is to promote locally manufactured goods. In the short run, the scheme operates more or less as tariff protection of infant industries.

Since no time limit is set as to how long local manufacturers can enjoy this incentive, in the ong run it may insulate domestic producers from foreign competition and make them less efficient as a result.

d. **Tariff Protection:**

Under the Southern African Customs Union Agreement (SACUA) Botswana may levy additional duties on imported goods to enable new industries cope with competition from other producers in the Common Custom Area provided that such duties are levied equally on goods produced in other countries from outside the Custome Area, either directly or indirectly. Protection may initially be granted for four years extendable for a further four years but may not exceed a maximum of eight years. Under the terms of SACUA investors may only benefit from one of the three major incentive schemes, FAP, LPS or Tariff Protection.

(e). **Exclusive Licence:**

In a situation where market demand is limited, resulting in a marginal investment projection, an investor may apply for an exclusive license for a specific area. The licence is granted for four eyars and may be extended for another four years.

4. Regulatory Framework:

Issues concerning the regulatory framework relate to:

* procurement by foreigners of valid work and resident permits as required by the Non Citizens Act.;
* regulations on commercial and industrial licensing through the licensing Boards in the MCI;
* regulations for land acquisition for commercial and industrial purposes through the Land Boards; and
* restrictions on employment under the Employment Act.

Prior to 1990 there had been considerable concern about regulatory restraint on industrial development. However, these issues were addressed by the Presidential Commission on the Revised National Policy on Incomes, Employment, Prices and Profits (March 1990) and extensive recommendations were made which were accepted by Government. For example with regard to procurement of resident and work permits, some streamlining procedures were adopted; also changes were made to ensure that licensing procedures are faster and more certain. Again the Employment Act is currectly being redrafted for review by the Regulations Review Committee.

The main problem with the regulatory framework lies with boreaucratic delays in their implementation.

Conclusion: In comparison with the other SADC countries, Botswana's investment policy seems to have paid off in terms of attracting a high % of total direct private foreign investment into the country. For example between 1985 and 1991 of the total flow of direct private foreign investment of $680 million into the SADC region Botswana alone attracted 52%. Whether this trend will continue in the future, will depend crucially on the extent to which the export oriented industries are able to withstand the competition posed by other industries in the entire Southern African Region including the Republic of South Africa. The competition is surely certain to become intensive if the political climate in RSA changes for the better.

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