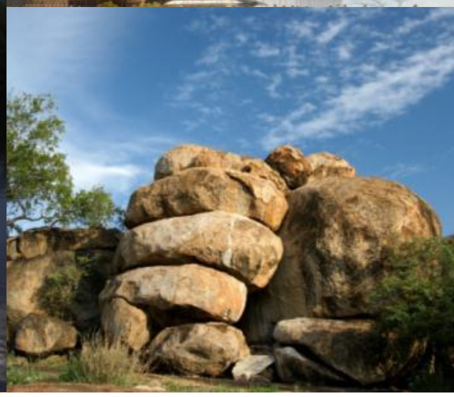
OECD Investment Policy Reviews: Botswana

Executive Summary and Recommendations





Preliminary version: October 2013

The Ministry of Trade and Industry of Botswana partnered with the NEPAD-OECD Africa Investment Initiative in 2012 to undertake an Investment Policy Review, with the support of the Government of Finland, based on the OECD Policy Framework for Investment (PFI).

This document has benefited from several fact-finding missions in Botswana, as well as from inputs from an All-Stakeholder Workshop hosted by MTI at the Gaborone International Conference Centre on 30 November 2012. The content and key recommendations of the Review have been approved by Government and all stakeholders as of October 2013.

FOREWORD

The *Investment Policy Review of Botswana* is one of five reviews carried out in member states of the Southern African Development Community (SADC) on the basis of the OECD Policy Framework for Investment (PFI). Undertaken by the NEPAD-OECD Africa Investment Initiative in the context of the "*Unlocking Investment Potential in Southern Africa*" programme with the support of Finland, it reflects the growing co-operation between the OECD and its African partners.

The Review is the result of a self-assessment undertaken by a national task force composed of government agencies, the private sector and civil society established by the government of Botswana and headed by the Ministry of Trade and Industry (MTI). The review process was launched during an inter-agency workshop hosted by MTI in July 2011 in Gaborone. Nineteen different government agencies were involved in responding to the PFI questionnaire and participated in all-stakeholder meetings as well as bilateral fact-finding sessions in May 2012. The findings of the *Review* were presented to all stakeholders and discussed in depth at the Gaborone International Conference Centre in November 2012, under the chairmanship of Boniface Mphetlhe (Deputy Permanent Secretary, MTI) and Peggy Serame (Economic Diversification Drive Unit). The next phase in the programme will involve follow up on the implementation of the Review's recommendations and regional co-operation on investment policy within the Southern African Development Community (SADC).

This Review has been prepared by Carole Biau under the supervision of Karim Dahou, Executive Manager of the NEPAD-OECD Africa Investment Initiative in the Investment Division of the OECD Directorate for Financial and Enterprise Affairs. The report has benefited from inputs by Hélène François, Mike Pfister, Stephen Thomsen, Dambudzo Muzenda and Mi-Hyun Bang in the Division. The secretariats of several OECD bodies, including the Investment Committee, the Committee on Fiscal Affairs, and the Committee on Corporate Affairs contributed to various chapters of the *Review*. The views contained within do not necessarily represent those of NEPAD member governments.

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EXECUTIVE SUMMARY

Starting in the late 1990s Botswana has made concerted efforts to attract FDI into export-oriented manufacturing and services, so as to reduce reliance on diamond exports and to diversify its supply-side capacities. Given that indications are that Botswana's diamond mines will be depleted within the next 20 years, diversification is becoming indispensable to safeguard growth, development and fiscal sustainability. Today the reform efforts of the authorities are consolidated under the Economic Diversification Drive (EDD), which emphasises the critical role to be played by the private sector in stimulating balanced and sustainable growth.

The Government has been closely engaged in improving the business climate for both foreign and domestic investors. Most recently, formerly distinct bodies responsible for financial and business services and for investment promotion have been merged into a single investment and export promotion agency, the Botswana Investment and Trade Centre (BITC). While Botswana also has sound laws providing for adequate investor protection these laws are not referred to in a single document and many investors are insufficiently aware of their rights. Likewise remaining restrictions on foreign investment, including preferences for citizen-owned companies, remain dispersed across different policies and regulations. This lack of clarity, which may underlie some of the recent declines in business climate rankings, should be comprehensively addressed.

Channels for public-private dialogue on investment policy could be rendered more efficient. While Botswana has an elaborate structure of public-private consultation, the Botswana Confederation of Commerce, Industry and Manpower (BOCCIM) is put under heavy strain to undertake the majority of policy advocacy on behalf of the business community. This may explain why the EDD Strategy is largely focused on public interest objectives such as job-creation and citizen empowerment, while private sector priorities like export promotion and investment attraction take more of a back-seat. In close consultation with private investors, Botswana could benefit from elaborating a dedicated national investment strategy geared towards the long-term investment attractiveness of 'niche' economic sectors.

Several markets remain heavily dominated by the public sector – particularly infrastructure sub-sectors where the playing field for private operators vis-à-vis public enterprises is often uneven. Moreover price rigidities complicate cost recovery for public utility providers, which are growing dependent on costly government subsidies as a result. Yet Botswana's infrastructure financing gap cannot be met through the public purse alone – especially in the energy sector, where further private participation, together with regional co-operation on cross-border power projects, will be necessary in order to tackle the energy generation challenge. Attracting and structuring private participation in infrastructure will also require more independent regulation of infrastructure markets, and a strengthened legal and institutional framework for public procurement and PPPs.

A labour force with specific and specialised skills will also be crucial in order to diversify the economy away from mining and attract investment into the services sectors. Unemployment remains high (at 17.8%), and takes a particularly heavy toll on the young – even at higher levels of education. The rate of graduate unemployment reflects a mismatch between skills and industry demand. This hampers the ability of domestic entrepreneurs to tap into business linkages with larger firms. Alongside infrastructure development, better-targeted human resource investments are a pre-condition for addressing Botswana's supply-side constraints and ensuring that investment generates spill-overs across the economy.

Key policy recommendations

Clarifying the legal framework for investment

- Group and streamline all sector restrictions on FDI within a regularly updated negative list. This rationalisation exercise should include regular assessments of the rationale behind each restriction, verifying whether the associated economic empowerment or employment goals could not be better met through alternative means.

- Consider putting together an Investor's Guide or Investment Code, which would group all relevant legal instruments for investment in Botswana (including laws granting protection provisions for investors and available systems of commercial dispute resolution, among others).

- Accelerate ratification record of Bilateral Investment Treaties signed by Botswana, and ensure that these are consistent with any 'umbrella document' of investment laws (above).

- Undertake a nation-wide assessment, broken down by geographic area and sector of investment, to diagnose barriers to land access across Botswana's different localities. This should notably aim to facilitate transfer of land titles and accelerate transformation of land type.

Targeting investment towards 'niche' sectors

- Create a national investment strategy, with a greater focus on sectoral competitiveness and export potential than currently exists in the EDD Strategy.

- Build on existing institutional structures for investment policy to ensure that such an investment strategy is aligned with human resource and infrastructure development strategies and targets.

- Introduce more transparency and coherence in the national system of investment incentives, possibly by listing all available incentives within a common document (see above). Alongside, ministerial discretion in awarding incentives should be reduced, notably by providing clear guidance concerning investor eligibility.

- Establish a mechanism for systematic cost-benefit analysis of tax incentives for investment, which would consider alternative uses of fiscal revenue (such as structural policies to enhance infrastructure and human resources) for investment attraction.

Creating a level playing field in infrastructure markets

- Engage in a gradual attempt to open the electricity market to companies other than Botswana Power Corporation, including by making space for more independent power provision.

- Support and accelerate efforts towards establishing the Botswana Energy and Water Regulator (BEWR) as an autonomous agency tasked with regulating tariffs and overseeing the competitive functioning of the water and energy markets.

- Develop a PPP Act and Regulations in coherence with the broader public procurement framework. This will require nurturing government capacity within relevant parts of the public administration (particularly the Ministry of Finance and the Public Procurement and Asset Disposal Board), and reinforcing Botswana's PPP Unit with experienced, full-time staff.

Encouraging employment and business linkages

- Build analytical and statistical capacity for human resource development, notably by capacitating the HRD Advisory Council to conduct sector-specific surveys of 'skill gaps'. Moreover elaboration of the Education and Training Strategic Sector Plan presents an opportunity for Botswana to adopt a more deliberate sectoral approach to HRD, geared towards available business linkage opportunities.

- Clarify BITC's role in promoting business linkages between small and large investors, in relation to similar responsibilities for other agencies (such as the Local Enterprise Authority or the EDD Unit). The rationalisation exercise begun between LEA and the Citizen Entrepreneurial Development Agency (CEDA) would deserve renewed momentum in this regard.

CHAPTER 1. OVERVIEW OF INVESTMENT POLICY CHALLENGES AND RECOMMENDATIONS FOR BOTSWANA

This chapter highlights Botswana's economic trajectory since independence, and the liberalization process engaged in recent decades. It demonstrates that Botswana has made vast progress in terms of improving its business climate, and is recognizing the need for a modernization of public sector roles and responsibilities vis-à-vis the private sector. The chapter then takes stock of Botswana's latest investment policy reforms and of the economy's recovery after the impacts of the global financial crisis – including through recent national growth and development strategies, such as the Economic Diversification Strategy (EDD) for 2011-2016. Lastly, persisting development and investment climate challenges are emphasised. This overview helps to uncover options for Botswana to channel new investment flows which can foster the growth of novel industries. It also proposes means for increasing investment linkages in the local economy, among large and small enterprises both domestic and foreign – including through investing resources in human resource development. Challenges and opportunities for channelling private sector participation towards the infrastructure sector are also addressed. Altogether, these policy recommendations strive for strengthening the legal and regulatory framework for investment in Botswana, in order to more coherently attract the FDI and local investment needed to realize the country's growth and diversification objectives.

The first part of this chapter provides a short description of the **macroeconomic environment and investment policy context** in Botswana. This is followed by an overview of **investment and growth trends** over the last two decades, including an analysis of the evolving **sectoral composition** of Botswana's economy. Botswana is currently one of the strongest performers on the African continent in terms of GDP per capita and social indicators. Although poverty levels remain quite high for a middle income country, the number of people living under the poverty line dropped from 30.6% in 2002/03 to 20.7% in 2009/10.[1] Over the past two decades and following the guidance of the **Botswana Excellence Strategy** (since 2008) and of the **Economic Diversification Drive** (since 2011), Botswana has moreover made significant progress in improving its business climate and increasing opportunities for foreign and domestic investors. However Botswana's doing business performance (as calculated by the World Bank Doing Business indicators) has stagnated, and most recently declined – reaching 59th position out of 183 economies in the 2013 report. In the aim of diagnosing the causes behind this deterioration, the government is now seriously examining remaining investment climate shortfalls.

The second part of the chapter accordingly identifies **dominant policy challenges** faced by Botswana in attracting investment across all economic sectors. This sheds lights on several strategic policy priorities that the country has to address in coming years, in order to bolster investor confidence and promote innovation and growth – including outside of the mining industry. The analysis contained in the subsequent chapters of this Review suggest that it remains particularly important to: clarify the existing legal and regulatory framework for investment; review the rationale behind remaining sector restrictions on foreign investment; simplify procedures for access to land; devise better-targeted development strategies that align investment objectives with human resource and infrastructure development plans; and level the playing field for private investors in infrastructure markets.

To a large extent these identified challenges match those highlighted by Botswana's last **National Business Council** (NBC 2012). The NBC, Botswana's largest forum for public private dialogue which is jointly hosted by private sector and Government on a biennial basis, identified the following as key bottlenecks to business expansion and economic competitiveness: the availability of land for business; the quality of education and training; the quality of infrastructure project implementation; and the slow pace of privatisation to date, including in infrastructure sub-sectors. This chapter ends with several **recommendations** to address these different obstacles, in view of assisting Botswana in enhancing foreign and domestic investment in the economy and maximising their development benefits.

1.1 Investment policy context

Increased engagement for attracting foreign investment

Botswana drafted a Foreign Investment Code in 2001-2002, which was intended to provide a uniform body of rules on investment. As the draft Code was however found too restrictive to foreign investors both by the Foreign Investment Advisory Service (FIAS, of the World Bank) and by UNCTAD, it was dropped in the interest of retaining a more open investment regime. Over the past two decades Botswana has therefore made significant progress for improving its business climate through other means. The **regulatory framework for investment** has been strengthened through a series of laws which: guide business establishment (such as the Companies Act); cater to investor protection (such as the Industrial Property Act, the Copyright and Neighbouring Rights Act, and the Acquisition of Property Act); and clarify modalities for investment in different economic sectors (such as the Mines and Minerals Act or the Public Procurement and Asset Disposal Act). Although some sectors of the economy – outlined in Chapter 2 – remain restricted to foreign ownership or continue to provide preferences to citizen-owned companies, the government has thus been closely engaged in improving the business climate for both foreign and domestic investors.

On the institutional front, to support this legal framework the **Botswana Export Development and Investment Agency** (BEDIA) was set up in 1997. BEDIA replaced its predecessor, the Trade Investment and Promotion Agency, as the central body empowered for investment promotion and facilitation in the country. In 2003 the Botswana International Financial Service Centre (IFSC) was in turn established with the aim of "developing Botswana as a world-class hub for cross border financial and business services into Africa".[2] Vision 2016 indeed upholds the **banking and financial service sector** as a promising opportunity through which Botswana can establish itself as a gateway for investment in the rest of Africa,[3] and many efforts have been made in this regard: the banking sector is well-developed and non-banking financial institutions (NBFIs, including pension funds and social security industries) are making headway – with pension funds growing by 15% between 2011 and 2012.[4] Botswana has also made strides in following international best practices for banking supervision, via a National Basel II Implementation Strategy which will be rolled out until 2017.[5] To further support the integration of financial services within the country's overall investment attraction activities, in 2012 IFSC and BEDIA were merged into the **Botswana Investment Trade Centre** (BITC), which is today the main body for promoting and facilitating investment in Botswana.[6]

A growing imperative for diversification: the Botswana Excellence Strategy and the Economic Diversification Drive (EDD)

This evolution in investment policy design and implementation has been accompanied by an increasing emphasis on **attracting investment outside of the diamond mining industry**. Botswana is today the largest producer of diamonds in the world by value and volume, and the mining sector is the biggest source of foreign direct investment (FDI), export revenues and GDP growth (see figures in next section). [7] One of Botswana's central development challenges and priorities has long been to diversify its economy away from this reliance on diamonds, particularly as the mining sector generates fewer backward linkages and high-wage domestic employment than most other industries.[8] Furthermore as Botswana's diamond mines will be depleted within the next 20 years, diversification will soon become indispensable to guarantee a source of government revenue and fiscal sustainability.

The Government is fully aware of this timeline. Starting in the late 1990s it began concerted efforts to attract FDI into export-oriented manufacturing and services, so as to reduce reliance on diamond exports and to diversify its supply-side capacities. In the aim of positioning Botswana as a preferred domicile for international investment flowing into Africa, Government also established the IFSC and enacted legislation bringing the management and jurisdiction of Botswana's financial services in line with international practices.[9] In 2005 the **Business and Economic Advisory Council** (BEAC) was created to identify constraints hindering economic diversification. This led to the elaboration of a Strategy for Economic Diversification and Sustainable Growth, the 2008 **Botswana Excellence Strategy**, which aims to "build sustainable diversification for a foreseeable post-diamond industry".[10]

The Excellence Strategy feeds into the country's guiding framework for long-term socio-economic growth (namely the **National Development Plan** (NDP) 10 and **Vision 2016)**, and commits Government to reducing bottlenecks to private sector growth, including by simplifying procedures for obtaining land, licenses and permits.[11] As part of the Excellence Strategy, over 2008-2010 Botswana developed a wide range of export and business facilitation strategies: the National Export Strategy; the Trade Policy; the Private Sector Development Strategy (PSDS); and the Investment Strategy for Botswana (ISB).

Since 2011, the structure for co-ordination of national investment policy has been quite thoroughly re-thought: the above sectoral economic development strategies are now incorporated within a new over-arching framework: the **Economic Diversification Drive** (EDD). The central agencies for design, implementation and co-ordination of the EDD Medium-Term and Long-Term Strategies (the **EDD Unit** and **National Economic Diversification Council**, NEDC) therefore form the focal points of investment and development policymaking in Botswana today.

The EDD was motivated by Government's commitment to promote local production and consumption of goods and services, as well as the need to develop new sources of growth and to expand exports. As reiterated in the resolutions of the 2012 National Business Conference, "the development of **export competitiveness is paramount in the light of the small domestic market**". Indeed small market size means that domestic producers cannot reach economies of scale and expand their industrial capacity if they cater to domestic consumers alone. Botswana therefore has "no alternative to openness".[12]

High priority placed on infrastructure development

Adequate physical and financial infrastructure is instrumental to the growth and competitiveness of Botswana given its strategic geographical location at the centre of Southern Africa. By developing good enabling infrastructure, the government aims to transform the country into a regional hub for FDI seeking to tap into neighbouring markets; this would also facilitate the consolidation of export niches in financial services and business process outsourcing. Infrastructure quality is significantly above average for the region, and attracts considerable government attention: by 2011 in the third year of NDP10 implementation, much of the Plan's budget had been taken up by water, power and roads projects as well as maintenance of existing infrastructure.[13] The largest share (26.82%) of the development budget for 2013/2014 will likewise be allocated to the Ministry of Minerals, Energy and Water Resources, in view of projects in emergency power supply, rural electrification and renewable energy, and water planning and development. The Ministry of Transport and Communications will receive the second-largest budget share (16.62%) for upgrading of airports, road and bridge networks, as well as development of ICT facilities. Meanwhile the Ministry of Local Government and Rural Development will receive 9.52%, a large part of which will go towards village infrastructure and village water provision. [14]

Privatisation is rising on the reform agenda

Despite the strong priority placed on infrastructure development however, private participation in most infrastructure sub-sectors remains low and private operators often face an **uneven playing field relative to public enterprises**. Following a period of initial openness to foreign investment at independence in 1966, for close to a decade Botswana indeed embarked on a trend of nationalisation, creating parastatals which were intended to complement FDI and to build local industrial capabilities which could later expand into manufacturing and services. While over-proliferation of these parastatals was avoided and the number of their control boards limited, most utilities and services (electricity, water and sanitation, fixed telecom, airline, and rail) today remain State-owned and closed to private investors.

While the large role of the government has thus been long unquestioned in Botswana, a key objective of the EDD Medium-to-Long-Term Strategy is that of 'weaning' Botswana's private sector from public support, and NDP 10 aims to cut Government expenditures to 30% of GDP by 2016 (from a peak of 42% in 2008-2009). Privatisation reforms have gained in prominence over the past two decades. Parliament approved a privatisation policy in April 2000,[15] which established the **Public Enterprise Evaluation and Privatization Agency** (PEEPA) under the Ministry of Finance and Development Planning. Following unsuccessful initial privatisation attempts, the first **Privatization Master Plan** was launched in 2005, and has since been updated with the Draft Privatisation Master Plan II for 2013-2018. The latter identifies services and public enterprises that are suitable for outsourcing and divestiture, including the Botswana Telecommunications Corporation (for which the first phase of privatisation was completed in November 2012). [16] There is thus growing recognition that a substantial change is necessary if further private sector involvement and economic diversification are to be achieved.[17]

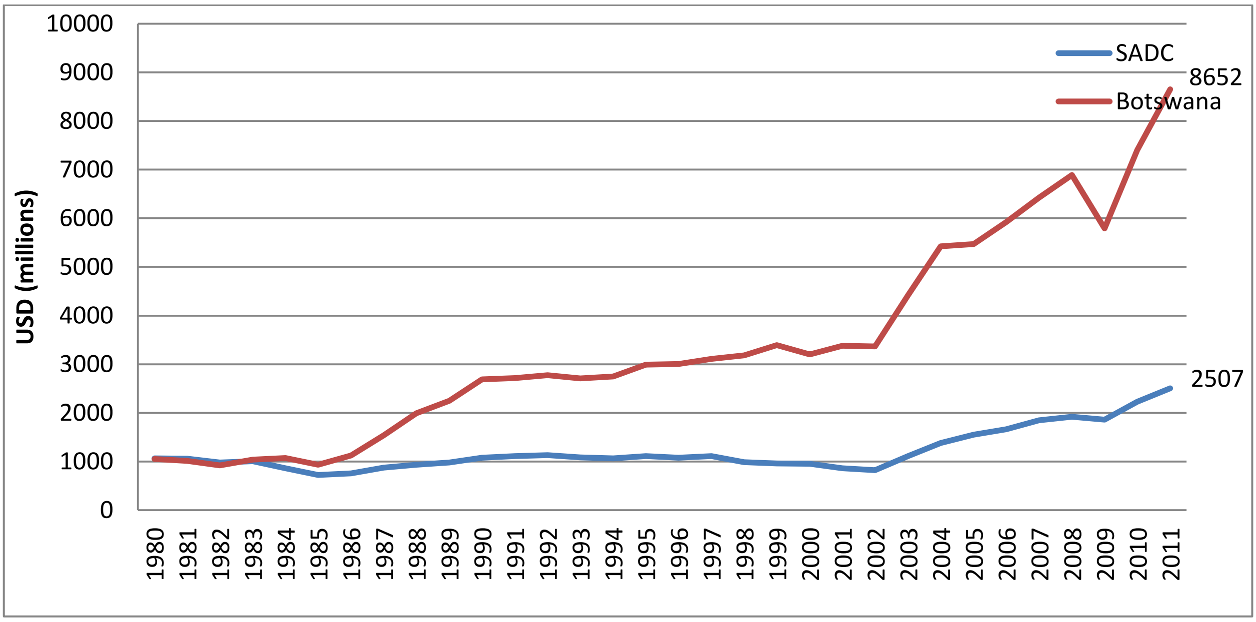
1.2 Macroeconomic environment

Strong growth since independence, based on sound use of mining revenues

At the time of independence in 1966, Botswana did not seem to offer the most conducive environment for rapid growth. Agriculture and infrastructure were both significantly underdeveloped vis-à-vis other sub-Saharan African countries. Botswana was also at a geographic disadvantage, as a landlocked country with a semi-arid climate and irregular rainfall. Nonetheless, a high rate of primary school enrolment at independence together with political and economic institutions conducive to the protection of private property rights, were important building blocks for creating a stable and sound business environment in the decades that followed.[18] The discovery of diamonds only one year after independence was an especially important boon for Botswana.

The key reforms for economic liberalisation described in the previous section, together with judicious use of Botswana's mining revenues through sound fiscal policy, enabled unprecedented **progression in GDP levels**. From Least Developed Country (LDC) status at the time of independence, Botswana reached Middle Income Country (MIC) status within three decades, in 1997. During this time per capita GDP increased by more than five-fold (in fact per-capita income has progressed almost continuously since the 1980s, aside from a shock related to the global financial crisis in 2009 – see Figure 1.1). Among Botswana's neighbours in the SADC region, only Mauritius and the Seychelles perform better in terms of GDP per-capita growth.

Figure 1.1: GDP per capita in Botswana and SADC, 1980-2011



Source: UNCTAD, 2012

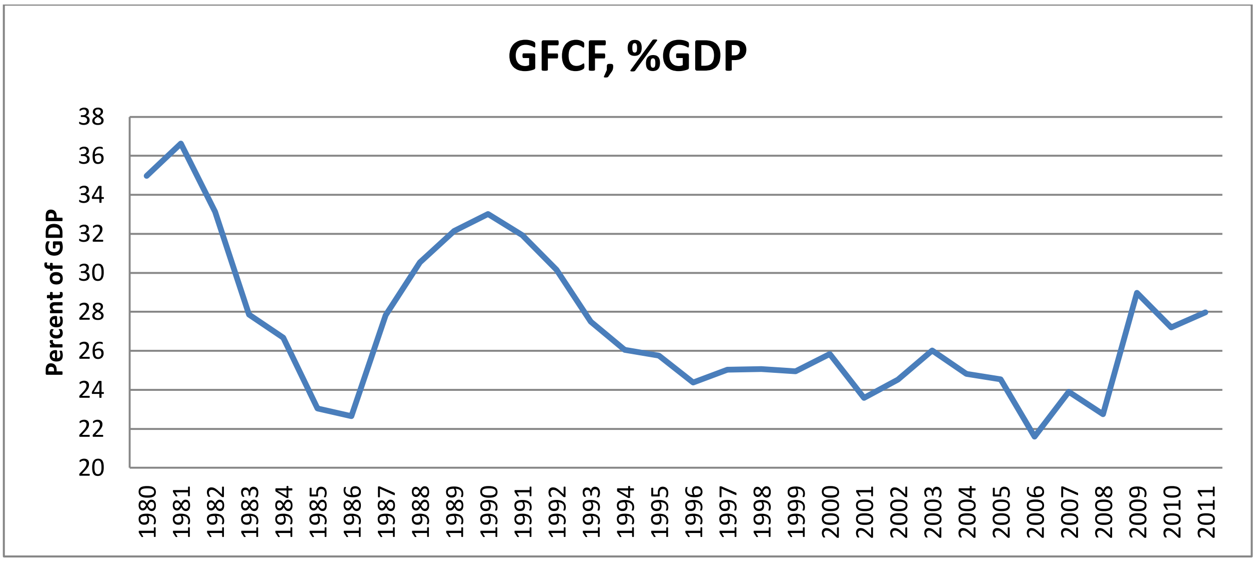
For these reasons Botswana is a frequently cited counter-example to the theory of the "natural resource curse" (see Box 4.1 in Chapter 4 below). Rather than generating avenues for corruption and irresponsible fiscal spending, Botswana has instead kept careful control of its foreign exchange and inflation, and has preserved a **sound governance record**. This is reflected in a consistently high scores in different global rankings – including among others: Transparency International's Corruption Perception Index (CPI), which places Botswana ahead of all other sub-Saharan African countries (at 30th position out of 178 countries), for 2012; the index of institutional quality in the World Bank's Governance Indicators;

and Moody's assessment of 'high' institutional strength, in light of "strong governance and successful implementation of forward-looking policies".[19]

Through ring-fencing mechanisms such as the Pula Fund (which facilitates targeted management of revenues from mineral tax and royalty payments), Botswana has thus channelled the budget surpluses linked to the diamond industry into public investments that have promoted growth and human development. For 2013-2014, spending on education will thus account for 22.98% of the recurrent budget, and health 12.81% (largely geared to combat the spread of HIV-AIDS, which is taking a very heavy toll on the population).[20] Due to the combination of strong growth together with vast improvements in social indicators, Botswana has frequently been described as "Africa's miracle".[21]

The **ratio of gross fixed capital formation (GfCF) to GDP** can provide an indication of the extent to which these GDP figures are sustainable and provide strong bases for future growth. This ratio signals how much value-added in total domestic production has been invested rather than consumed (notably in the form of land improvements, machinery and equipment purchases, and physical infrastructure). Following wide variations in the 1980s, Botswana's GfCF/GDP ratio has ranged between 22% and 26% for most of the past two decades, rising closer to 30% in the past two years (Figure 1.2). This is slightly above the standard for African countries (about 21-22%) and follows the average for industrialised countries (about 23-25%). However as marginal returns to additional capital are in any case low in more industrialised economies (which already have large volumes of pre-existing capital stock), Botswana could potentially do better in terms of channelling production revenues into long-term investments. Indeed the GFCF/GDP ratio still falls short both of many emerging economies (for example in East Asia, where rates reach 35-40%), and of the ratio initially targeted by Vision 2016 (an average of 40% for 1996-2016).

Figure 1.2: GFCF as a share of GDP, 1980-2011



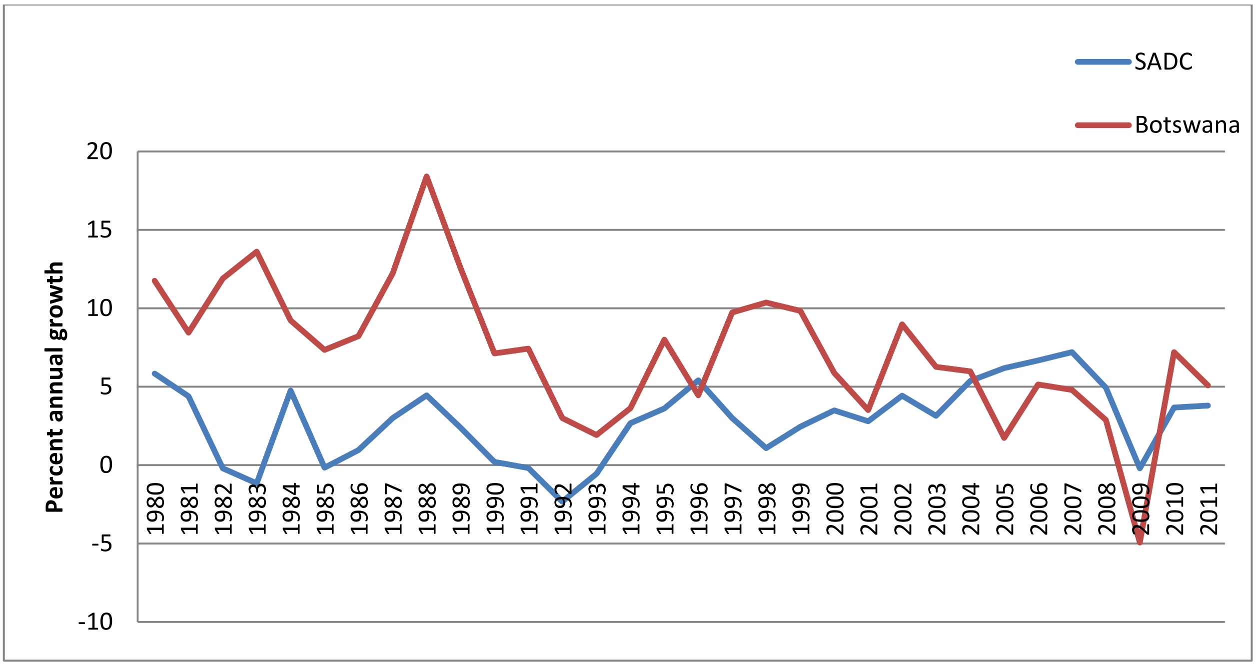
Source: World Data Bank & UNCTAD, 2012

Impact of mining industry on overall growth and stability

Botswana's growth model has nonetheless remained closely tied to the performance of the mining industry. Whereas over 1990-2011 GDP growth mostly oscillated between 5% and 11%, these rates dropped considerably in 2008-2009 (Figure 1.3 below illustrates that this shock was more pronounced in Botswana than in most SADC economies) as a result of the economic crisis which cut back demand for minerals. Subsequently production slumped by as much as two-thirds and mines down-scaled their operations. The resulting budget deficit (13.5% of GDP in 2009) forced Botswana to take a USD 1.5 billion loan from the African Development Bank, the largest ever granted by the institution[22].

Recovery has been fragile since: while real GDP in the mining sector grew by 9.7% in 2011-12 due to regained global demand for diamonds (which rose by 23.7% in the second quarter of 2011), the Euro-zone crisis then caused diamond sales to plunge again (by 70% between July and December 2011). Unsurprisingly, from a predicted 2012 growth rate of 7.1% in the 2011 Budget[23], realised growth then reached only 6.1% - largely due to the decline in mining sector output. [24] Carat sales and revenue fell by 13% and 19% respectively in 2012, and several mines which had re-opened in early 2012 (such as Lerala Mine and Venture BK 11) are now back on care and maintenance.

Figure 1.3: GDP growth in Botswana & SADC (1980-2011)



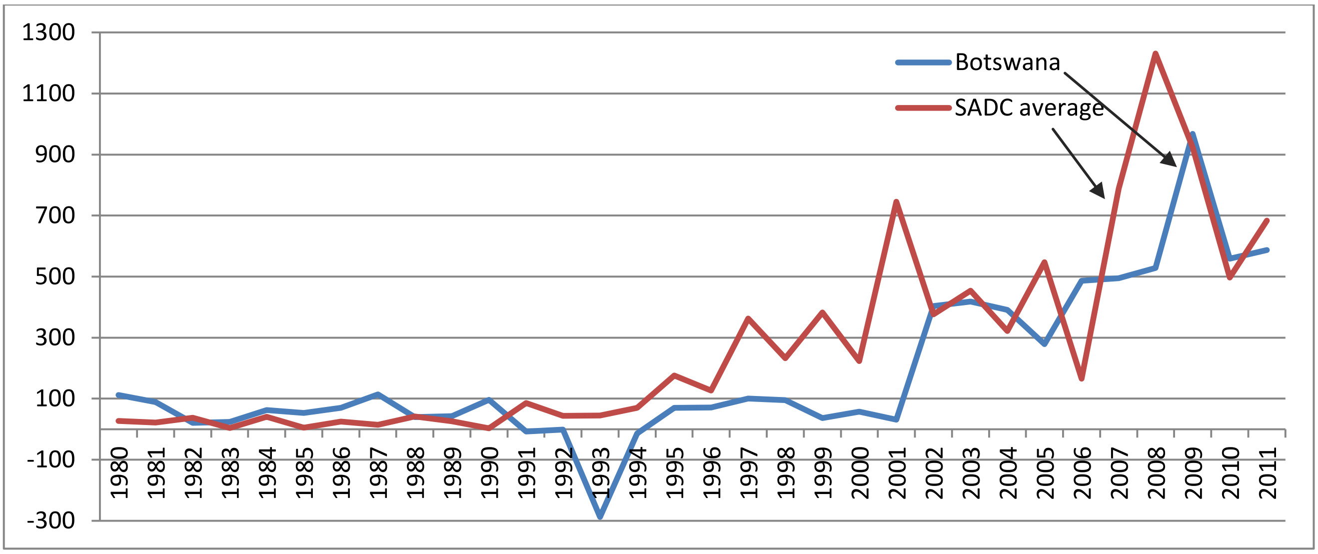
Source: UNCTAD, 2012

Botswana has nonetheless put in place several **safeguards for macroeconomic stability** since the financial crisis. A statutory cap on government debt has been set at 40% of GDP (20% external and 20% domestic, as per the Stock, Bonds and Treasury Bills Act). By end January 2013 total government debt had been reduced to 28.737 billion Pula (USD 3.57 billion, or approximately 23.5% percent of 2012/13 GDP). Meanwhile the fiscal deficit, which stood at 11.5% of GDP in 2010, was reduced to 6.1% in 2011 and to just 3.1% in 2012. The credit rating agencies Moody's and Standard & Poor's have maintained the country's investment grade ratings in the "A" categories (A2 and A- respectively) for eight consecutive years,[25] and although in February 2010 Standard & Poor’s imposed a minor downgrade and Moody’s adjusted its outlook from stable to negative,[26] since November 2011 the outlook has returned to stable.[27] In a similar vein, Business Monitor International (BMI) ranks Botswana second in its Sub-Saharan Africa risk/reward ratings for 2012, and views Botswana to have “the most attractive risk profile in the region”.[28]

Foreign investment trends

Net **FDI inflows** to Botswana have ranged between about USD 20 million and 100 million over most of the 1980s and 1990s, before undergoing considerable expansion in the new millennium (reaching a peak of USD 968 million in 2009, following which the financial crisis cut the trend short). Botswana's FDI performance holds up quite well to the SADC average (see Figure 1.4, where the SADC figures include the performance of South Africa). Outside of oil-producing countries, Botswana has been Africa's sixth most attractive target for FDI between 2003 and 2011 (after Kenya, Uganda, Tanzania, Zambia and Mozambique).[29] Investment has moreover begun recovering since the crisis, and over 2011-12 Botswana received additional investment inflows of a record 1.4 billion Pula (USD 176 million), with 1 583 jobs created from these new investments.[30]

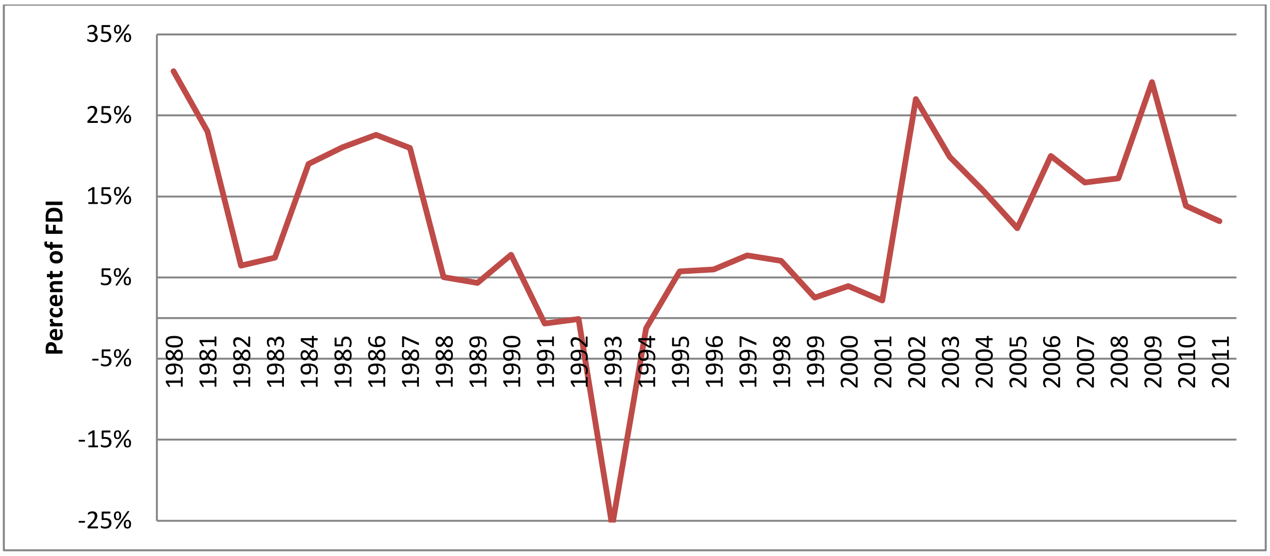
Figure 1.4: Net FDI inflows into Botswana vs. SADC average, 1980-2011



Source: UNCTAD, 2012 (note: SADC average includes South Africa)

However these FDI volumes remain rather small in absolute terms, and have only amounted to 2-4% of GDP for most of the past two decades (with the exception of a high of 8.4% in 2009). This is far below international standards. Simultaneously, the **ratio of FDI inflows to GfCF** has been extremely variable, ranging from above 25% to under 5% over the same period (Figure 1.5). While for larger and wealthier countries FDI does not closely influence total gross capital formation (as capital can be generated through other, domestic sources of investment), small export-dependent countries such as Botswana should exploit the potential of FDI as a major source of capital investment. Therefore alongside efforts geared at attracting more FDI, Botswana may benefit from directing a larger share of these flows towards sectors of greater value-addition and capital creation (such as infrastructure, which has relied mostly on public sector financing so far).

Figure 1.5: FDI inflows as a share of GFCF, 1980-2011



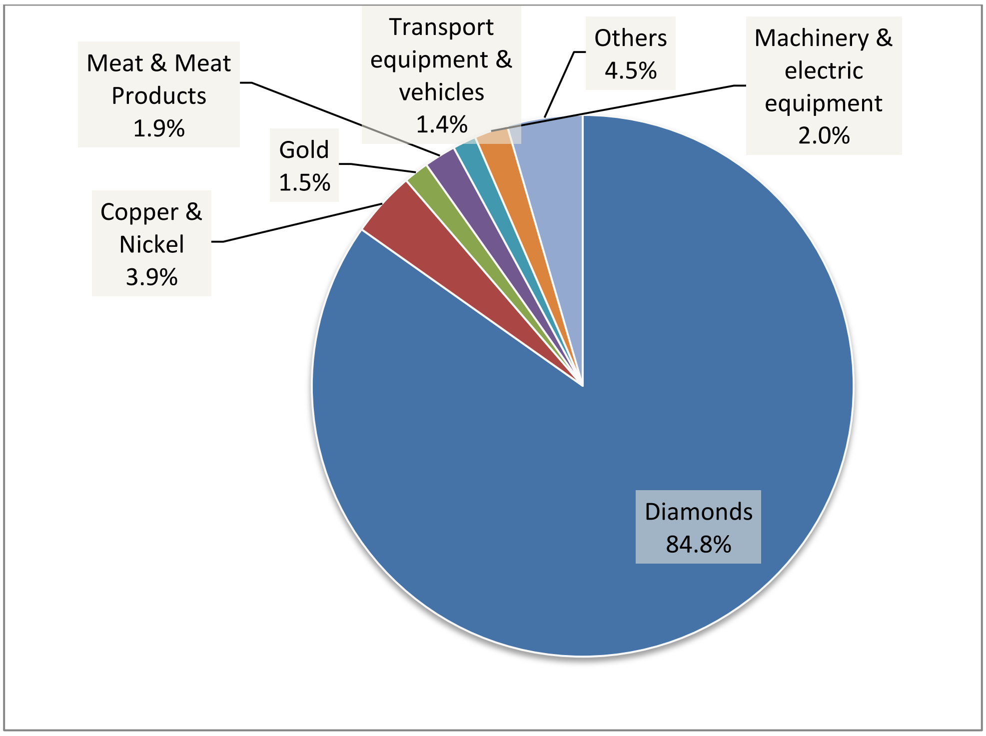
Source: World Data Bank & UNCTAD, 2012 Export and import composition and the trade balance

Given the narrowness of Botswana's domestic market (a small and sparse population of a little over two million), most **FDI in the country has been export-oriented** rather than domestic market seeking. Most of this FDI has traditionally been from Europe (especially Luxemburg, where the De Beers diamond company is headquartered) and from South Africa. Over 2003-2011 the bulk of FDI (38%) has gone into diamond mining, followed by metal ores, financial services, communications, real estate and hotel and tourism.[31] FDI into the financial sector nonetheless temporarily outstripped new investments in mining in 2006, thanks to IFSC efforts to position Botswana in the insurance market: IFSC launched new services for insurance companies in view of filling a market niche for multi-country insurance products. Promising sub-sectors for FDI attraction in the financial services, aside from insurance and reinsurance, include regional investment banking and structured financing operations, and business processing outsourcing.

Trade balance

Export composition has likewise been dominated by the mining sector: in 2006 Botswana's Export Concentration Index (ECI) was the second-highest in Africa (after Angola).[32] As of August 2012 diamonds formed 81.4% of exports, far ahead of copper and nickel at 3.9%, and meat products at 1.9% (Figure 1.6). While the main purchaser has long been the United Kingdom (64.4% of total exports in August 2012, after a peak of 74% in 2008),[33] exports to SADC countries have been rising and reached 20.3% in August 2012, mostly channelled toward South Africa and Namibia (14.4% and 3.3% respectively).[34] The trade with these neighbouring markets is based mostly on exports of salt and soda ash, and is expected to strengthen as integration within the SADC and the Southern African Customs Union (SACU) gathers speed.[35] Export composition reveals that while Botswana has the ambition of positioning itself as an exporter of tourism and business process outsourcing services, this has yet to materialise in reality.

Figure 1.6: Export composition in Botswana, 2012

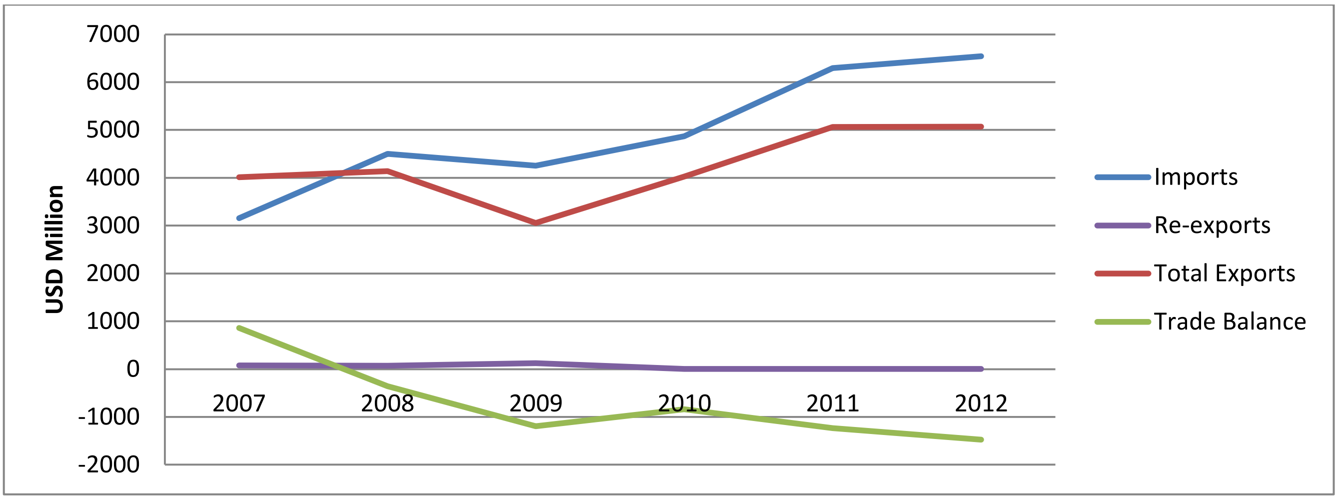


Source: Statistics Botswana, October 2012

Import composition in turn reveals that the majority of imported goods are intermediary (input) products like machinery (17.4% as of August 2012), chemical products (11.4%) and fuel (25%, a reflection of Botswana's energy generation challenges). Food also features prominently among imports (at 12.4%), given that only some 5% of Botswana's land area is cultivable and that domestic food crop production meets less than a fifth of domestic consumption needs.[36] The vast majority of imports to Botswana are from South Africa (84% for August 2012), compared to 6.3% from Asia, 4.7% from the European Union, and almost none from other African countries.

When diamond trade is included in Botswana's import figures (including temporary trade, composed of diamonds that come to Botswana for aggregation followed by re-exportation), the country's **international merchandise trade** has displayed almost consistent deficits since the fourth quarter of 2008 (Figure 1.7).[37] The balance has grown increasingly negative since 2008-9, due to the combined effects of the crisis-related collapse in export revenues and to increased import spending in the country.

Figure 1.7: Botswana Imports, Exports and Trade Balance, 2007-2012



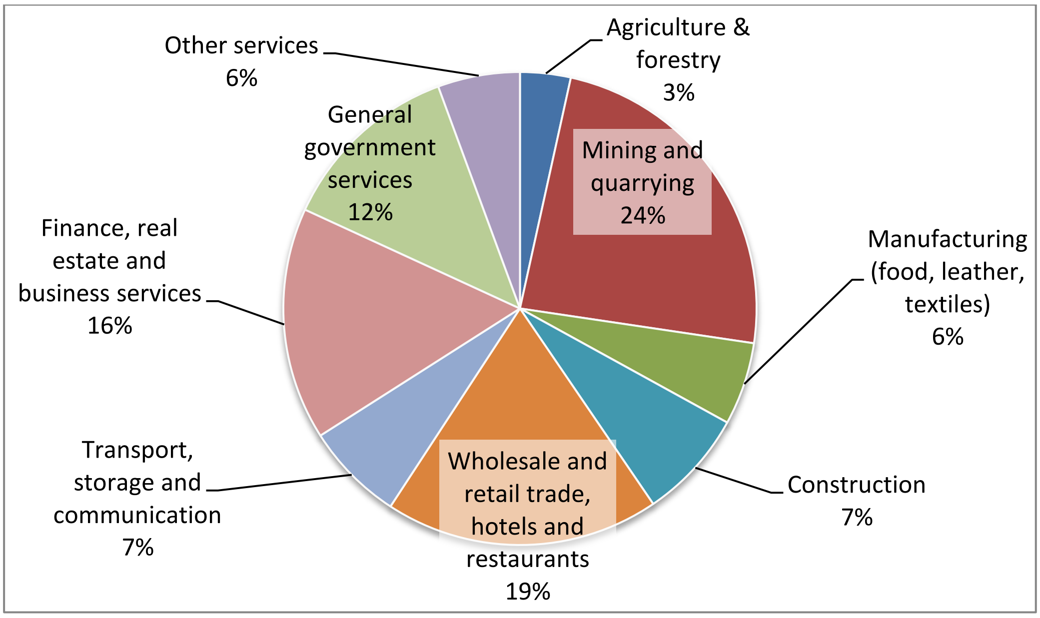
Source: Statistics Botswana, October 2012

1.3 Increasing structural change in the economy of Botswana

Botswana's economy is undergoing **progressive structural change**, which is increasingly visible in terms of the contributions of different economic sectors to: GDP; total value-addition; and employment (each addressed in turn below). This is also reflected by an encouraging drop in Botswana's Herfindahl-Hirschmann index over time: this indicator of economic diversification, which trends towards zero as diversification increases in the economy, had dropped from 0.24 in 2007 to 0.195 by end 2011.[38]

As concerns **sector contributions to GDP**, the share of mining to GDP has declined from 34% in 2011 to 24% by the second quarter of 2012; the total decline over 2012-13 is estimated at 12.5%. Likewise while mining revenues constituted 55% of government revenue in 2001-02, this share has fallen to 41.6% by 2011-12. By contrast the rest of the economy has grown at 11.6% over 2012-13, pointing to accelerating diversification.[39] Combined, tourism, manufacturing and services (including finance) have thus risen to reach over 60% of total output since 2011(see Figure 1.8). The share of non-mineral private and parastatal sectors in the economy is expected to reach 70% by 2016.[40]

Figure 1.8: GDP per sector, Quarter 2 of 2012

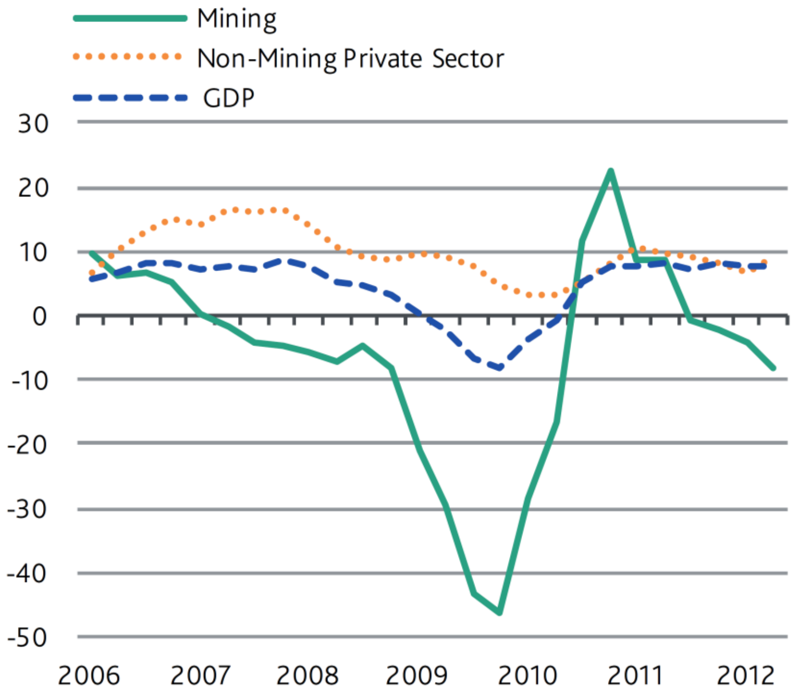


Source: Bank of Botswana, National Summary Data Page (NSDP). October 2012.

Capital spending focusing on priority projects to promote economic diversification accounts for some 30% of the total Government budget.[41] Of **non-mining sectors**, construction was the fastest-growing industry for the first half of 2012 (growing by nearly 22% compared with the first half of 2011). This was followed by: transport and communication (13%); utilities (11.2%); social and personal services (10%); and manufacturing (5.5%).[42] These dynamic rates have counterbalanced the instability in the mining sector (see Figure 1.9 below). The Ministry of Finance therefore forecasts 5.9% growth for 2013.[43]

Among these dynamic growth sectors, the recent absence of the **financial sector** stands out: the competition in this respect remains very tight, especially given the close vicinity of South Africa, the continent's financial powerhouse. Moreover, the most recent economic downturn put a strong brake on financial deepening, with the ratio of banking assets to GDP declining from 49% to 43% between 2010 and 2011.[44] Rather than on finance, the bulk of new investments for 2011-2012 were thus mostly concentrated in steel manufacturing, farming, non-diamond mining, tourism, property development, ICT development and renewable energy.[45] Key structural bottlenecks (including insufficiently enabling infrastructure, and poorly tailored skills in the national labour force) may in particular be preventing Botswana from fully exploiting its potential in the financial services and business process outsourcing sectors.

Figure 1.9: Annual growth of mining and non-mining sectors versus GDP, 2006-2012

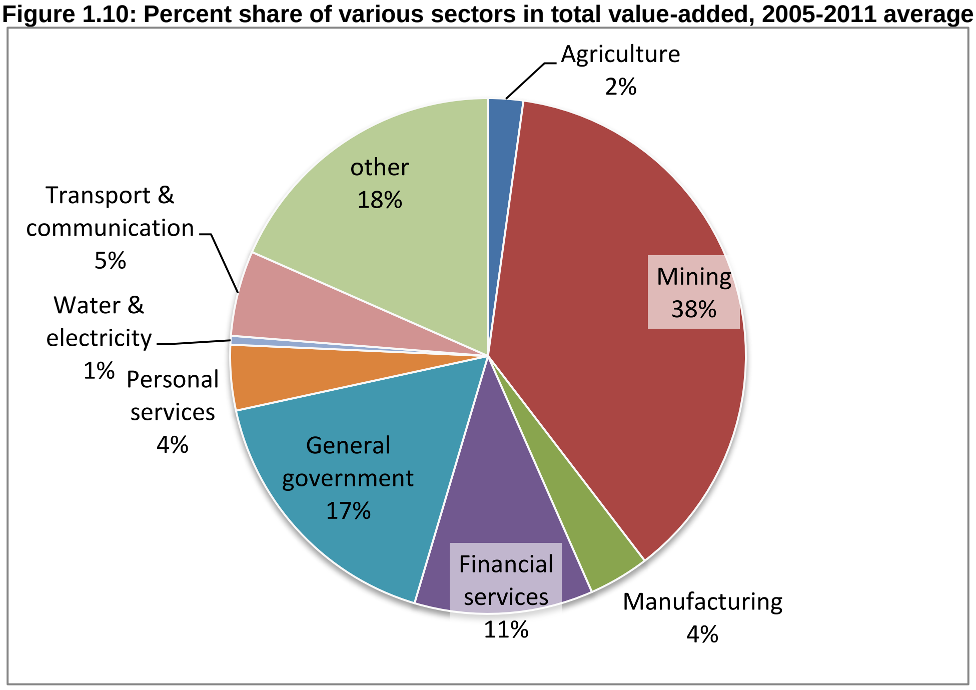


Source: Central Statistics Office Botswana, featured in: Moody's Annual Report 2012, 27 November 2012.

The Government has also begun promoting more **diversification within the mining industry** itself, including by: elaborating a Coal Roadmap and establishing a Coal Development Unit; considering review of the Mines and Minerals Act to better cater for the development of uranium and coal bed methane; and creating additional legislation to facilitate the development of a downstream gas industry.[46] These developments are expected to go hand-in-hand with accelerated infrastructure investment, in particular increasing production to support the extension of Botswana's power grid, and preparing the coal sector for exports.[47]

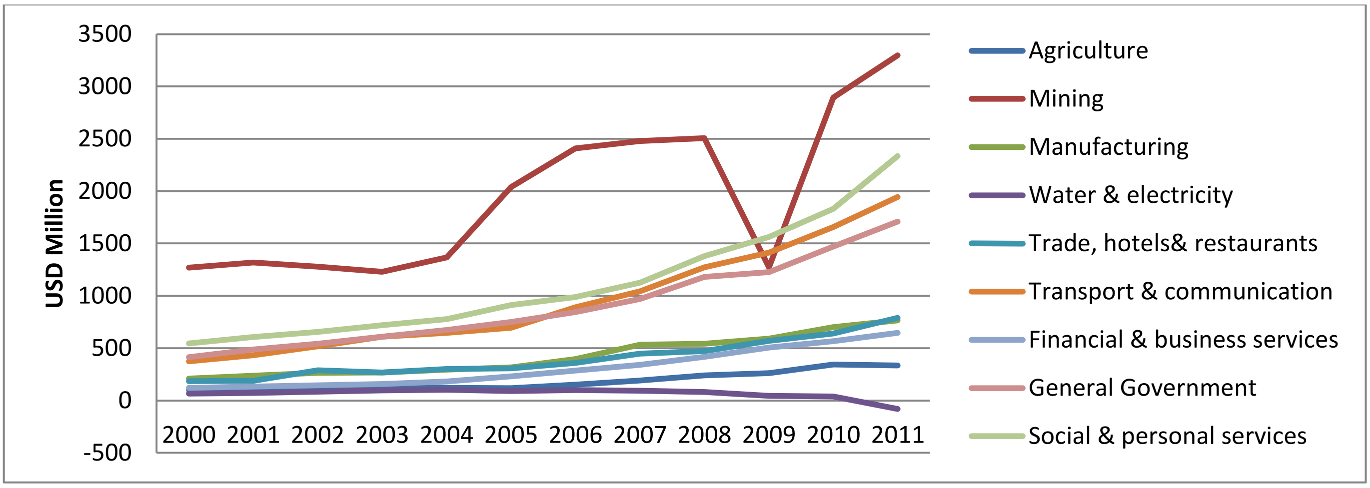
The structural change of the economy is also reflected in the evolution of **value-addition by industry**. Over 2005-2011, mining contributed 38% of total value-added in Botswana, followed by general government spending and financial services (at 17% and 11% respectively – see Figure 1.10). Figure 1.11 suggests that the value-added of transport and communication, as well as manufacturing, are now on an increasing trend. The agricultural, manufacturing, financial and transport sectors have all increased their shares of total value-added between 2011 and 2012, whereas the mining industry has lost ground (from an average of 37.4% of total value-added over 2005-2011, to 28.8% by August 2012). Likewise the **fastest growing industries in terms of job creation** within the formal sector (all of which have maintained average annual employment growth rates of over 7% since 1975) have been: finance and business services; manufacturing; trade; transport and communications; and government. Mining remains far behind and generated only 3% of total employment as of June 2011.[48]

Figure 1.10: Percent share of various sectors in total value-added, 2005-2011 average



Source: Statistics Botswana, October 2012

Figure 1.11: Value-added by industry, 2000-2011



Source: Statistics Botswana, October 2012

1.4 Main investment policy challenges

The legal framework for investment would benefit from greater clarity

Despite the many reforms undertaken by Botswana over the past two decades to improve its business environment, the country's **ranking in the World Bank's annual Doing Business Reports** has declined for the past four years consecutively, reaching 59th out of 185 economies in the 2013 report. [49] The World Economic Forum's Global Competitiveness Report (GCR) likewise highlighted a slip from 76th out of 179 countries rated for 2009-2010, to 79th out of 144 in 2012-2013.[50] This performance is not necessarily a cause for concern – as the decline in rank may simply reflect an increased pace of reform in other countries, rather than declining investor confidence in Botswana itself; and moreover the ranking has since well improved, to 74th position out of 148 countries for 2013-2014. This places Botswana at the fourth-best spot among Sub-Saharan African countries covered.[51] Nonetheless the performance of the previous few years had prompted concerns from investment policymakers, and triggered the creation in 2011 of a Cabinet Committee of Ministers (the **National Doing Business Committee**, NDBC) to address the improvement of the country's business environment.[52]

Botswana's attractiveness as an investment destination depends on the strength and clarity of **regulatory and legal framework for investment**. Botswana has a sound series of laws related to the investment environment, which provide for adequate investor protection in line with most international standards (including safeguards for property rights and expropriation). Nonetheless **restrictions on foreign investment and ownership**, including preferences for domestic investors, remain dispersed over several different strategic documents and regulations. This hampers awareness of available investment opportunities, particularly for foreign investors. It also hinders Government efforts to accurately and regularly **evaluate the desirability** of these restrictions and incentives on investment flows, including assessing whether the objectives of such measures might not be better attained through alternative (less discriminatory or fiscally costly) means.

The regulations governing **access to land** also remain excessively cumbersome for investors. This is one of the key bottlenecks highlighted by the National Business Conference 2012, which notes that the inflexible approach to land use hampers entrepreneurial activities by restricting the availability of land for business, making it difficult for land to be re-allocated to more productive economic uses, and imposing restrictions on ownership and transfer of land. The need to relax and simplify procedures for access to land, and especially for change of land use for business purposes, is urgently highlighted by the private sector.

A related challenge is that the laws guaranteeing investor protection have so far not been grouped within a common document, and as a result investors are insufficiently aware of the reliability of Botswana's investment regime. This lack of clarity, rather than the quality of the investment regime itself, may be responsible for some of the decline in business climate rankings. **Grouping all these laws together** (for example in a legal text such as an Investment Code, or simply within a regularly updated Investor's Guide) would make them more easily accessible and would provide investors with greater assurance in terms of openness, transparency and predictability.

Need for a more strategic and sector-targeted approach to investment attraction

As introduced above, the EDD Strategy represents important progress in terms of rationalising the country's economic development strategy. However, although the EDD in principle incorporates most elements of the Investment Strategy for Botswana, **the role of FDI and dedicated strategies for investment attraction** are not well emphasised within the EDD. The investment policy related interventions proposed in the Medium to Long-Term Strategy (under the responsibility of the Thematic Team on Investment and Finance) thus apply only to business facilitation in a broad sense, and do not aim for more ambitious and comprehensive reform of investment policies. **Export-promotion** also appears to have taken somewhat of a back-seat: the conclusions of the NBC 2012 deplore that while the economy has diversified since the launch of the EDD, this growth and diversification "has generally been driven by firms focused on the domestic market, and there has been little progress with the diversification of exports".[53]

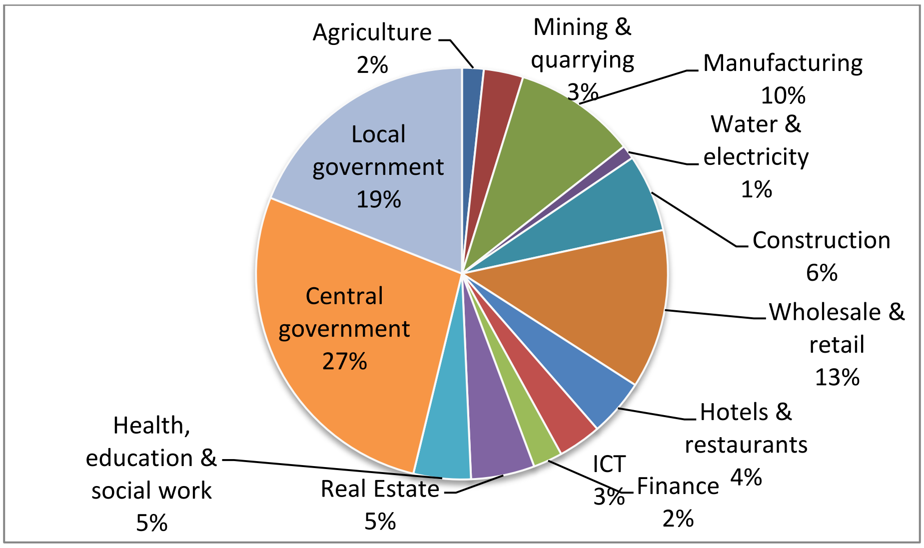
The EDD's identification of priority sectors for intervention is thus based most prominently on empowerment and poverty-reduction considerations, with insufficient emphasis placed on export potential or strategic investment attraction. Finance and business process outsourcing are two economic sectors, among several others, that would benefit from more strategic market analysis. Botswana may thus suffer from **the lack of an investment-specific strategy**, either within the EDD or as a self-standing element. This would also help identify and tackle specific bottlenecks to the expansion and export competitiveness of promising ‘niche’ sectors, including supply-side constraints (in both labour supply and enabling infrastructure).

A coherent, long-term approach to investment attraction would also necessitate improved communication with and **involvement of the private sector in investment policy advocacy** and strategic planning. Indeed while Botswana has an elaborate structure of public-private consultation – especially through the Botswana Economic Advisory Council (BEAC), and the Botswana Confederation of Commerce, Industry and Manpower (BOCCIM), which channel private sector concerns to the High-Level Consultative Council and to the new Special Cabinet Committee on Doing Business and Competitiveness – this multiplicity of communication channels may be counter-productive and is not sufficient to guarantee a strong and sustained policy dialogue. BOCCIM is for instance the sole umbrella body representing the private sector, and as such is solicited by Government on all sides (as co-chair of the NDBC, main private sector interlocutor at the HLCC, and as a member of almost all EDD Thematic Teams, among other responsibilities). This puts considerable strain on the agency, which has few staff and limited resources. In addition other private sector bodies – such as BEMA, the Botswana Exporters and Manufacturers Association – are far less vocal in terms of policy advocacy.

Considerable skills mismatch on the labour market

As of June 2011 the private sector accounted for 48.5% of total employment, followed by Central Government (26.3%), Local Government (20.8%) and Parastatals (4.4%).[54] Within private sector employment, wholesale and retail provided the most employment opportunities, followed by manufacturing and construction (see Figure 1.13). Yet although overall employment rates increased by 7% from June 2010 to June 2011,[55] unemployment remains high in Botswana (at 17.8% in the 2009/10 Labour Force Survey), and takes a particularly heavy toll on the young – even at higher levels of education.[56] This reflects a **mismatch between skills and industry demand**. Diversifying the economy away from mining and attracting investment into the services sectors (in particular finance and business process outsourcing) will require a labour force with specific and specialised skills.

Figure 1.13: Distribution of employment across sectors of the economy, June 2011



Source: Statistics Botswana. June 2011 Formal Sector Employment. October 2012.

This has implications in terms of investment attraction and competitiveness, as it limits the ability of domestic entrepreneurs to tap into possible business linkages with larger firms. The 2011-2012 GCR Report notes that "Botswana's primary weaknesses [in terms of competitiveness] continue to be related to its human resources base" – mostly due to low levels of educational enrolment and low quality of the educational system by international standards.[57] The 2013-2014 report draws similar conclusions, and the 2012 National Business Conference, which brought together a wide range of public and private sector representatives, deplored that Botswana's public education system "continues to produce poorly trained graduates who cannot find jobs, partly because they bring qualifications that are not relevant to the labour market". Although a variety of progammes have been implemented to help address youth unemployment (including financial support programmes, training, entrepreneurship development, and work experience), these have had limited success – and yet there are few mechanisms available for accurately evaluating the quality and relevance of these programmes, and of education provision more generally.

Botswana has taken this challenge seriously, by attempting to better align education curricula and vocational training with the needs of industry via the National Human Resource Development Strategy (NHRDS) of 2009. To address on-going concerns with respect to access, quality and relevance of education, a comprehensive **Education and Training Strategic Sector Plan** is moreover being developed since December 2012, with completion expected during 2014-15. The Ministry of Education proposes to spend 20 million Pula (USD 2.4 million) on the elaboration of this plan. Such HRD strategies could usefully be complemented by the elaboration of a clear national investment strategy for the country, and benefit from an emphasis on strategic investment policy interventions within the EDD (as detailed above).

Many infrastructure opportunities remain un-tapped in Botswana

Despite efforts to accelerate infrastructure development, there remains a shortage of enabling infrastructure for private investment in Botswana. The 2013-2014 GCR ranks the country 78th out of 148 economies in terms of the quality of its overall infrastructure (a significant deterioration relative to the previous year, where Botswana was placed 64th out of 144 countries). Energy access and capacity is of particular concern: Botswana must import most of its electricity from South Africa, which combined with the cost of transport and electricity transmission, significantly raises electricity prices. The very small size of the domestic market and the dispersion of the sparse population moreover render economies of scale and scope difficult to realise, further raising costs. Since 2006 Botswana faces a major **electricity generation challenge**, which will require further regional co-operation and cross-border power projects – as the completion of domestic power projects currently underway (including Morupule B and Orapa) will not suffice to strengthen the country's electricity supply security.

Compounding the capacity problem, there is a financing gap across all infrastructure sub-sectors, which cannot be met through the public purse alone. Yet opportunities to mobilise private investment in Botswana's infrastructure so far remain underexploited. This is in part due to policy constraints. Possibilities for **greater private participation in infrastructure markets** are accordingly being considered by Government, including through the **Public-Private Partnership** (PPP) route. In 2012 the NEDC made clear its decision of fast-tracking PPP implementation in the country. However although a 'PPP Policy and Implementation Framework' was elaborated in 2009, Botswana still has no PPP act or regulations, and the existing Public Procurement and Asset Disposal (PPAD) Act makes no explicit reference to the specific modalities of PPP projects. A dedicated legal framework and institutional structure may help attract private bidders for PPP contracts. The absence of a PPP act and regulations and the very limited capacity of Botswana's nascent PPP Unit currently risk weakening Botswana's credibility vis-à-vis potential private partners for infrastructure PPP contracts.

Whether or not it enacts binding PPP legislation, Botswana's ambitions to become a regional transportation and logistics hub and to attract more private participation in infrastructure development will also crucially depend on the **state of the playing field** between public and private operators in infrastructure markets. The predominance of **state-owned companies** across all infrastructure sectors limits competition, especially since not all infrastructure sectors have empowered and independent regulatory authorities. Moreover **price rigidities** in infrastructure markets have complicated cost recovery for public utility providers (especially Botswana Power Company and the Water Utilities Corporation), which have grown increasingly dependent on costly government subsidies as a result. As the delicate balance between cost-effective pricing and user affordability also has important implications for attracting private investors in these markets, this requires serious consideration by government; establishing an **independent regulator** for the water and electricity sectors (see below) could play an important role in this regard.

1.5 Investment policy options

1. Clarify the legal framework for investment

1.1 To better showcase and strengthen efforts at economic opening, Botswana would benefit from clearly listing within a single document the **economic sectors in which foreign investment is restricted**, or screened according to certain criteria (such as size or employment potential).

- Restrictions according to investor origin, capital thresholds, and sector of investment should all be clearly stated in this **negative list**, which should be regularly updated in view of full transparency vis-à-vis investors. It should include core exceptions (which can be established in the interest of national security or in strategic sectors) as well as restrictions that are based on the country's development strategy (such as ownership or procurement preferences by sector). In addition to this list of restrictions on foreign equity ownership, a common Investment Code or investor guide (see recommendation 1.2 below) should clearly itemise restrictions affecting freedom of entry and investor establishment and operations in each sector, as well as differential access to procurement contracts or to finance.

- When establishing this list, the government should aim at **streamlining restrictions** dispersed across different sectoral legislations, analysing opportunities and costs of these restrictions, and limiting their number with a view to attracting foreign investment across a large range of industries. In particular it will be necessary to **assess the rationale** behind each of the restrictions, notably to verify whether the empowerment or employment goals of these regulations could not be better met through alternative means.

1.2 Given the good quality of Botswana's existing investment legislation, it does not appear necessary to implement a separate Investment Law (as this may just add an unnecessary layer to the country's legal environment). Nonetheless an **Investor's Guide or Investment Code**, grouping all relevant legal instruments for investment in Botswana, would help clarify the legal regime for investment and would better showcase its strengths (especially abroad). This instrument should be designed so as to complement the existing BITC Act, which is focused on investment promotion.

- Such a codification or listing process should mention all relevant laws granting **protection provisions for investors**, such as: commitments to fair and equitable treatment as well as full protection and security; compensation for losses in case of armed conflict and civil disturbances; provisions on transfer of funds; guarantees against direct and indirect expropriation; key personnel; and access to means of Investor-State dispute settlement as well as commercial dispute settlement (including recourse to national courts as well as to international and domestic arbitration). The fact that Botswana has lifted foreign exchange controls and that repatriation of profits and assets is free would also be worth mentioning in this Code or Guide.

- The Investor's Guide or Investment Code should also reflect compliance with all international commitments of the country, and be consistent with Bilateral Investment Treaties signed by Botswana (Botswana's ratification record for these Treaties is also weak and ratification of existing Treaties should be accelerated). The coherence of the legal framework for investment could moreover be further enhanced by improved systems of **commercial dispute resolution**, including updating of the Arbitration Act and establishing dedicated commercial courts (given that the existing Industrial Court deals mostly with employment rather than investment disputes).

- To guide this codification process, Botswana may wish to make use of existing **policy advocacy bodies**, such as: the NEDC and its sub-bodies (the EDD Unit, the EDD Thematic Team on Investment and Finance, etc.); BOCCIM for the private sector; and the National Doing Business Committee (NDBC). Based on wide stakeholder participation, these bodies would establish the broad objectives and orientations of investment policy, identify existing regulatory gaps, and set out what specific problems the Investment Code or Investors' Guide would seek to address. This structure would also be responsible for regularly updating the document (in the case for instance of any changes to sector-specific limits on foreign ownership, which would need to be reflected in the proposed negative list).

2. Elaborate a sector-focused national investment strategy

The above codification process would also present a good opportunity to create a comprehensive **national investment strategy**, with a greater focus on sectoral competitiveness and export potential than currently exists in the EDD Strategy.

- Botswana's national market is too small to provide many promising industries with sufficient demand; therefore beyond the EDD goals of citizen empowerment, poverty reduction, and diversification, it is essential that Botswana devise a clear strategy for catering to regional and global markets, and for attracting foreign investment accordingly. This will require targeted interventions in sectors that have strong comparative advantage, and attracting and facilitating investment in these sectors of high export and growth potential.

- Such a strategy could be devised in a self-standing manner, or within the EDD framework – for instance by the EDD Thematic Team on Investment and Finance. It would need to clearly lay out strategic objectives and help identify the main structural bottlenecks to the expansion of promising industries, such as finance or BPO. It would also provide a basis for long-term, sector-focused targets within human resource and infrastructure development strategies.

3. Further facilitate land ownership, transfer and rental

Botswana should build on the **electronic systems for land registration** already in place, and should endeavour to make the **transformation of land type** (from tribal to state or freehold) faster and more flexible. Transfer of land titles should also be facilitated, but preferably not through auctions as has sometimes been the case for commercial land (see Chapter 2).

- Given that land access is not a challenge country-wide (rather, ease of access depends on location of the land and on the facilitation of the local authorities concerned), a **nation-wide assessment**, broken down by geographic area and sector of investment, would help to diagnose and better tackle the problem. This could also facilitate the benchmarking of progress made in securing land access across Botswana's different localities.

- The recent initiative to directly allocate land to relevant Ministries who can then accelerate the application process for investors should be carefully monitored and evaluated, as it poses multiple risks. Indeed, multiplying the lines of accountability for land management and award could reduce transparency and instead open avenues for corruption and for arbitrary, negotiation-based decision-making. Rather it will be important to establish a **clearer arrangement of responsibilities** among MTI and the Ministries of Lands, and Labour and Home Affairs so as to maintain transparency while accelerating the availing of land, as well as the issuance of residence and work permits. The resolution of the National Business Conference 2012 with respect to land access goes along similar lines, advocating the elaboration of a comprehensive national spatial planning framework which could help increase transparency and efficiency in the national and sub-national management of rural and urban land.

- Any **decentralisation of land management** to local authorities (including, for tribal land, the Land Boards) should be progressive and accompanied by the necessary mechanisms for oversight, transparency, and right of appeal and compensation for the landholders and investors concerned – including oversight by a single central agency. A representative of government could exercise ex-post control on land transfers by local authorities, with the support of administrative tribunals. 3.

4. Clarify and review award and rationale of investment incentives

Botswana has one of the most straightforward corporate tax systems in the world, and the system is mainly consolidated through the Botswana Unified Revenue Service (BURS). Discretionary measures however remain possible within the system, as the Minister of Finance may for instance issue orders granting additional tax relief to any project considered beneficial to Botswana's economic development. Currently these incentives are also mentioned in separate acts and regulations (such as the PPAD Act, the Mining and Minerals Act or the Citizen Economic Empowerment Policy), and are not centralised within a common document where they can be readily available to investors.

- Botswana could therefore introduce **more transparency and coherence in its system of investment incentives**. All available investment incentives could be listed within a common investor guide or Investment Code (see recommendation 1.2). This would help reduce the current ministerial discretion and instead provide clear guidance concerning eligibility for these incentives. Centralising all incentives within a common document could moreover assist policymakers by highlighting areas of potential duplication, and may facilitate the impact evaluation exercise.

- It would also be important to develop a mechanism for **regular impact assessment** of tax incentives for investment. It is crucial to ensure that incentives are fulfilling their objectives (i.e. attracting more investment), by subjecting them to both *ex ante* and *ex post* evaluations to determine their effectiveness and their impact on the national budget. Botswana could consider endowing the nascent BITC Financial Incentives Committee with the necessary mandate and capacity for such evaluations. The latter should notably consider whether the public objectives pursued by the incentives could not be better achieved through alternative means for investment attraction (the foregone fiscal revenue could for instance instead be invested in structural policies for investment attraction, such as improving enabling infrastructure and the economy's skills base).

5. Level the playing field for investment in infrastructure markets, especially water and energy

Attracting private participation in Botswana's infrastructure markets will require ensuring that private operators can bid for contracts, and more generally do business, on an equal footing with public companies. This raises a group of sequential issues:

- First, **sound SOE governance and financial transparency** are crucial in order to shed light on any loss-making areas of SOEs, where functional separation and a delegation of tasks to the private sector may be most justified and desirable; sound SOE governance can also better pave the way for attracting private participation to the sector and for successful divestiture, should this be the preferred option for government.

- Second, there is a need for strong control and risk mitigation mechanisms to address the new challenges involved in the shift from public to private (or mixed) provision of infrastructure services. This includes: a clear and transparent **public procurement framework** (to ensure that bids are competitively assessed, including for PPP projects); ensuring that bids (especially in the case of PPPs) are selected with adequate attention to risk-sharing, budgetary oversight and Value for Money; and mechanisms for market regulation and appropriate pricing of infrastructure services.

- Third and more broadly, structuring private participation in infrastructure markets requires full alignment of all relevant **legal and regulatory frameworks** and the administration (notably to ensure consistency with former regulations on concessions and procurement, and to align line ministries and regulatory bodies against these common infrastructure development objectives).

The following recommendations attempt to address these challenges across different infrastructure sub-sectors in Botswana:

5.1 Engage in a gradual attempt to **open the electricity market** to companies other than BPC. In addition to encouraging increased structural separation of the power sector (BPC for instance already engages in power purchase contracts with IPPs), government could consider **functional separation** of integrated utilities. This can allow to better identify areas in which public utilities are recording profits or losses, and highlight the segments which would be best-suited for private sector participation. Moreover agencies such as the Local Enterprise Authority (LEA) may want to ensure that small domestic enterprises have the requisite skills and training to enable them to enter IPP contracts.

5.2 Support and accelerate the work of the **Botswana Energy and Water Regulator** (BEWR) Taskforce, set up in 2012 to establish a regulatory framework for the energy and water sectors. This will also require developing an Energy and Water Regulation Act. Establishing an independent regulator for the energy and water sectors would help regulate tariff increases, not only in energy (where tariffs have risen by 30% over the last two years, but where cost recovery remains difficult), but also in water (so to as to make the sector more financially sustainable). In the short-term, the balance between cost-effective pricing and user affordability may be better met through **consumption subsidies rather than production subsidies**, so as to allow power and water companies to operate on cost-recovery principles.

5.3 Given Botswana's narrow market size, place increased emphasis on cross-border infrastructure projects, as well as on developing **interconnections in the transport sector** which would facilitate the expansion of export-oriented production targeting regional and international markets.

5.4 Create a **regulatory framework for PPP development** (beyond the existing PPAD Act, which makes no provisions specific to PPP contracting). Building on the basis of the 2009 PPP Policy and

Implementation Framework, a PPP Act and Regulations could be developed by procurement experts and budget officials in-house, rather than relying on external consultants (which has purportedly led to delays). Nurturing government capacity and reinforcing Botswana's fledgling PPP Unit is also necessary, and staff for this could be recruited – even on a temporary basis – from relevant institutions outside of MFDP (such as PPADB).

6. Build analytical and statistical capacity for human resource development (HRD)

Capacity remains weak for analysing and forecasting Botswana's labour supply and demand. Labour Force Surveys are conducted infrequently (only every ten years), and as of yet there is no systematic evaluation or forecasting of labour demand and skills gaps by sector and industry. Meanwhile the institutional landscape of agencies charged with development and implementation of HRD strategies remains blurred, although dedicated agencies are to be established in 2013 to remedy to this shortcoming.

- **Evaluation of Botswana's educational and vocational training system** should be strengthened: the recently-established HRD Advisory Council (HRDAC) should be capacitated to play a central role in conducting regular sector-specific surveys of 'skill gaps', so as to shape the national education and training system accordingly.

- Based on a better understanding of existing and forecasted labour market gaps by sector, the elaboration of the Education and Training Strategic Sector Plan over 2013-2015 should be taken as an opportunity for Botswana to adopt a more **deliberate sectoral approach** in its HRD strategies. Within this Strategic Sector Plan, specific attention should be placed on developing a competitive human resource base in economic activities where Botswana may have a comparative advantage in terms of investment attraction relative to other countries in the region.

- Meanwhile both the private sector and institutions tasked with HRD (particularly the forthcoming National HRD Council, which will be formally established in a Bill before Parliament in 2013) should be granted a more systematic role in **policy advocacy**. Once operational, the HRDC should also be fully capacitated for its task of reducing overlap among different agencies working on HRD in the country. Government should in addition accelerate the move towards innovative incentives for further encouraging employers and business to train employees or to **co-finance training** and labour market analysis.

7. Strengthen implementation and communication dimensions of investment facilitation

7.1 Together with the private sector, Government should consider means of **streamlining channels of communication** among itself, investors, and BITC. It is also necessary to strengthen the main umbrella group for the private sector (BOCCIM), and also to better delegate BOCCIM's advocacy functions among other available bodies – essentially diversifying the voice of the private sector in Botswana.

7.2 Following the merger between BEDIA and IFSC, BITC will moreover need to firmly **define its approach to investment facilitation** (either as a one-stop shop, or – as is more recently being considered by BITC directors – via a model that would service bare requirements for investors *in-situ*, while tackling questions pertaining to other government agencies through negotiated service-level agreements). The agency would need to be empowered accordingly, and the corresponding lines of accountability and oversight made clear. As concerns investment facilitation for SMEs, although it has run into delays in 2012, rationalisation of mandates between LEA and the Citizen Entrepreneurial Development Agency (CEDA) would also deserve renewed momentum.

- As the One-Stop Shop for investors that BEDIA had operated was never fully effective, and few investors used the service, BITC direction is currently considering a variety of approaches to investment facilitation. Once identified (including through consultation with the private sector), the desired approach should be clearly laid out and publicised. Especially if any 'silent consent' frameworks are envisaged (which the Ministry of Trade and Industry has been considering in light of successful reforms in other countries, notably Mauritius), establishing **clear lines of accountability and oversight for all investment facilitation decisions** will be imperative.

- BITC's role in **promoting business linkages between small and large investors** should also be clarified, in relation to similar responsibilities incumbent on other agencies (such as the Local Enterprise Authority, LEA, or the EDD Unit). BITC will for instance have a role to play alongside these agencies in designing and implementing the Entrepreneurship Development Policy, which is currently under formulation as a potential replacement for the 1998 SME Development Policy. The new policy should seek to address more contemporary SME needs, including access to innovative forms of finance, intellectual property rights for SMEs, and facilitated participation in PPP and procurement projects.

- BITC could additionally make use of the Investor Aftercare Questionnaire (previously distributed by BEDIA) to **identify structural gaps** in the enabling environment for doing business – such as assessing shortages of local suppliers, skills, and infrastructure. This would enhance BITC's value-added in terms of policy advocacy.

Box 1.1: The OECD Policy Framework for Investment

The Policy Framework for Investment (PFI) was developed to help governments "mobilise private investment that supports steady economic growth and sustainable development, and thus contribute to the prosperity of countries and their citizens and the fight against poverty" (PFI Preamble).

Inspired by the 2002 United Nations Monterrey Consensus on Financing for Development, which ascribes to governments the responsibility for creating the right conditions for private investment to flourish, the PFI aims to support development and the fight against poverty and to promote responsible participation of all governments in the global economy.

The PFI represents the most comprehensive multilaterally-backed approach to date for improving investment conditions. It addresses some 82 questions to governments in 10 policy areas to help them design and implement good policy practices for attracting and maximizing the benefits of investment. The PFI is based on the common values of rule of law, transparency, non-discrimination, protection of property rights in tandem with other human rights, public and corporate sector integrity, and international co-operation for development.

Several countries participated in developing the PFI, including some 30 OECD and 30 non-OECD governments. Business, labour, civil society, and other international organizations, such as the World Bank, also played an active role, and regional dialogue and public consultations were organized around the world. The PFI was endorsed by OECD ministers in 2006, when they called on the OECD to continue to work with non- member governments and other inter-governmental organizations to promote its active use. Already, Morocco, Indonesia, China, India and Zambia are some of the countries that have undertaken a self-assessment of their investment framework based on the PFI.

Based on analysis of what sectors would most benefit from reform and best stimulate the rest of the investment environment (as explored in the preceding overview), the Ministry of Trade and Industry of Botswana decided to focus on four distinct policy areas of the PFI: Investment Policy; Investment Promotion and Facilitation; Public Governance; and Infrastructure.

Source: www.oecd.org/investment/pfitoolkit

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