PROSPECTS FOR EXPORT DIVERSIFICATION IN BOTSWANA

Botswana Institute for Development Policy Analysis
Gaborone
Botswana

The World Bank
Poverty Reduction and Economic Management 1
Southern Africa
Africa Region

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ISBN: 99912-911-7-2

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Design and layout: Impression House, Gaborone, Botswana
Printed by: Impression House, Gaborone, Botswana, 2006

ISBN: 99912-911-7-2

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CURRENCY EQUIVALENTS

Currency Unit = Pula (P.)

US$1 = P4.54

(Effective April 27, 2005)

FISCAL YEAR

July 1 - June 30

Acronyms and abbreviations

ACBF	African Capacity Building Foundation
ACP	African, Caribbean and Pacific
AGOA	African Growth and Opportunities Act
ARCS	Administrative and Regulatory Cost Survey
ASYCUDA	Automated System of Customs Data Management
ATC	Agreement on Textiles and Clothing
BDC	Botswana Development Corporation
BDVC	Botswana Diamond Valuing Company
BECI	Botswana Export Credit Insurance and Guarantee Company Limited
BEDIA	Botswana Export Development and Investment Authority
BIDPA	Botswana Institute for Development Policy Analysis
BLNS	Botswana, Lesotho, Namibia and Swaziland
BMC	Botswana Meat Commission
BNCS	Botswana National Conservation Strategy
BoB	Bank of Botswana
BoBCs	Bank of Botswana Certificates
BOBS	Botswana Bureau of Standards
BOC	Botswana Ostrich Company
BOCCIM	Botswana Confederation of Commerce, Industry and Manpower
BOTA	Botswana Training Authority
BOTASH	Botswana Ash
BPC	Botswana Power Corporation
BPO	Business Process Outsourcing
BSE	Bovine Spongiform Encephalopathy
BTA	Botswana Telecommunications Authority
BTC	Botswana Telecommunications Corporation
BURS	Botswana Unified Revenue Service
BWP	Botswana Pula
CAP	Common Agricultural Policy
CET	Common External Tariff
CEDA	Citizen Entrepreneurial Development Agency
CET	Common External Tariff
CIF	Cost Insurance and Freight
CITES	Convention on International Trade in Endangered Species

COMESA	Common Market of Eastern and Southern Africa
COR	Certificate of Rights
CSO	Central Statistics Office
CYTAX	“current year tax”
DAHP	Department of Animal Health and Production
DCC	Duty Credit Certificate
DFID	Department for International Development
DoT	Department of Tourism
DTI	Direct Trade Input
DWNP	Department of Wildlife and National Parks
EAOB	Exporters Association of Botswana
EPA	Economic Partnership Agreements
EPZ	Export Processing Zones
ERP	Effective Rate of Protection
ESAMLG	Eastern and Southern Africa Anti-Money Laundering Group
EU	European Union
FAP	Financial Assistance Policy
FDI	Foreign Direct Investment
FIAS	Foreign Investment Advisory Service
FMD	Food and Mouth Disease
FOB	Free on Board
FPSG	Fixed Period State Grant
FSC	Financial Sector Commission
FTA	Free Trade Area
GATS	General Agreement of Trade in Services
GATT	General Agreement on Trade and Tariffs
GCC	Gaborone City Council
GDFI	General Directorate for Foreign Investment
GDP	Gross Domestic Product
GNI	Gross National Income
GoB	Government of Botswana
GRCO	Gaborone Regional Customs Office
HATAB	Hotel and Tourism Association of Botswana
HHI	Hirschmann-Herfindahl Index
HIES	Household Income and Expenditure Survey
HLCC	High Level Consultative Council
IBCs	International Business Corporations
ICC	International Chamber of Commerce
ICD	Inland Clearance Depot
IDA	Industrial Development Act
IDZs	Industrial Development Zones
IFSC	International Financial Services Centre
IMF	International Monetary Fund
ISC	International Services Centre
JITAP	Joint Integrated Technical Assistance Programme
LDC	Less Developed Countries
LITS	Livestock Identification and Trace Back System
LLA	Local Licensing Authority

MCI	Monetary Conditions Index
METRs	Marginal Effective Tax Rates
MFA	Multi-Fibre Agreement
MFDP	Ministry of Finance and Development Planning
MFN	Most Favoured Nation
MIDP	Motor Industry Development Programme
MLHA	Ministry of Labour and Home Affairs
MoA	Ministry of Agriculture
MoE	Ministry of Education
MoH	Ministry of Health
MTI	Ministry of Trade and Industry
MTR	Mid Term Review
NCSA	National Conservation Strategy Agency
NDP	National Development Plan
NEER	Nominal Effective Exchange Rate
NEMIC	National Employment, Manpower and Incomes Council
NILA	National Industrial Licensing Authority
NISB	National Immigrants Selection Board
NLA	National Licensing Authority
NTBs	Non Tariff Barriers
OECD	Organization for Economic Co-operation and Development
OIE	Office International des Epizooties
OMPP	Ostrich Management Plan Policy
PAYE	Pay As You Earn
PEEPA	Public Enterprise Evaluation and Privatization Agency
PPI	Producer Price Index
PPP	Public Private Partnership
PSM	Per Square Meter
RC	Registrar of Companies
RCA	Revealed Comparative Advantage
REER	Real Effective Exchange Rate
RIR	Real Interest Rate
RISB	Regional Immigrants Selection Board
RLA	Regional Licensing Authority
ROE	Return on Equity
ROW	Rest of World
RPMD	Registrar of Patents, Marks and Designs
SACU	Southern African Customs Union
SACUA	Southern African Customs Union Agreement
SAD	Single Administrative Document
SADC	Southern African Development Community
SARS	South African Revenue Service
SAT	Self Assessment Tax
SLAAC	State Land Allocation Advisory Committee
SMEs	Small and Medium Enterprises
SPS	Sanitary and Phytosanitary Standards
SPVs	Special Purpose Vehicles
TCDA	Trade Cooperation and Development Agreement

TCPB	Town and Country Planning Board
TEC	Tertiary Education Council
TILB	Tourist Industry Licensing Board
TIN	Taxpayer Identification Number
TRIPS	Trade-Related Aspects of Intellectual Property Rights
TPRM	Trade Policy Review Mechanism
TRQ	Tariff Quota
TSA	Tourism Satellite Accounting
TSG	The Services Group
UNCTAD	United Nations Conference on Trade and Development
UNICITRAL	United Nations Commission for International Trade Law
USA	United States of America
USAID	United States Agency for International Development
VAT	Value Added Tax
VET	Vocational Education and Training
VCF	Venture Capital Fund
VOIP	Voice-Over Internet Protocol
WIPO	World Intellectual Property Organization
WTO	World Tourism Organization
WTO	World Trade Organization
WUC	Water Utilities Corporation

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PREFACE

Economic diversification is a major policy objective of the Government of Botswana and has been a key determinant of macro and microeconomic policy. The Ninth National Development Plan, covering the period April 2003 to March 2009, adopted the theme "internationally competitive sustainable economic diversification". However, despite this policy focus, diamonds remain the dominant export and source of foreign exchange.

Against this background the Government requested that the World Bank undertake a collaborative study with the Botswana Institute for Development Policy Analysis (BIDPA) on the constraints and opportunities for export diversification. This partnership has combined the World Bank's cross-country knowledge with BIDPA's deep understanding of Botswana's institutions and political economy. The study represents the views of both organizations and, it is hoped, will be a major step in continued collaboration. The study was also conducted in partnership with COMMARK Trust, a DFID-funded grant making organization focused on making markets work for the poor, which co-financed and implemented the ostrich, and garments and textiles sub-sector studies.

The study was undertaken between May 2004 and May 2005. Elwyn Grainger-Jones (consultant) was team leader and lead author of the report under the supervision of Happy Fidzani (Executive Director, BIDPA) and Fahrettin Yagci (Lead Economist, World Bank). Kennedy Mbekeani (Senior Research Fellow BIDPA) assisted in coordinating BIDPA's trade inputs for the study, with Jay Salkin (Senior Macroeconomic Policy adviser, BIDPA) as overall BIDPA internal reviewer. Peer reviewers were Dr Joel Sentsho (University of Botswana), Philip English (Senior Economist, WBI Trade, World Bank), and Jeffrey Lewis (Manager, DEC, World Bank).

A number of background studies were prepared as an input for the report, and are available as discussion drafts on BIDPA's website (www.bidpa.bw). The case studies for this report were chosen to reflect a mix of traditional, non-traditional sectors, successful and challenged sectors. Sub-sector studies were undertaken on beef, ostrich, textiles, automobiles and parts, tourism and financial services exports. Background studies were also conducted on the impact of the exchange rate on exports and on the labour market's impact on exports.

This study has benefited from a recently-completed Investment Policy Review prepared by UNCTAD, a FIAS study on the regulatory and procedural framework for private investment, studies on diversification in manufacturing, services and agriculture produced by BIDPA for the World Bank, a WTO Trade Policy Review of the Southern African Customs Union (SACU), USAID-funded trade work undertaken for the SADC Mid-Term Review, and various other existing government and non-government reports.

A well-attended consultation workshop was held in Gaborone on March 11, 2005. As can be seen from the Action Plan, this study requires follow-up and further research on a number of fronts. As such it should not be seen as the end-point for collaboration between the World Bank, BIDPA and the Government of Botswana on this important issue.

Finally, the fact that this study contains many suggestions for policy change should not detract from Botswana's reputation as one of the most successful economies in Africa. Other studies, such as World Bank (2003) "Botswana: A Case Study in Successful Growth", focus more on what countries can learn from Botswana. This study focuses on how Botswana can sustain this strong record.

ACKNOWLEDGEMENTS

The Study benefited from excellent assistance and collaboration with Government. The study team would like to thank in particular the staff of the Ministries of Finance and Development Planning, the Ministry of Trade and Industry, the Bank of Botswana, BEDIA, and the IFSC for valuable guidance and assistance. The study team found government officials to be universally open and helpful, with a common desire to share knowledge to contribute to development in Botswana.

Funding was generously provided by the Dutch Government under the Bank Netherlands Partnership Program. Co-financing was generously provided by BIDPA and the COMMARK Trust. COMMARK Trust financed and managed background case studies on the textiles and garments industry and on the ostrich industry. Lolette Kritzinger-van Niekerk (World Bank Senior Economist, Botswana Country Economist) provided valuable advice and guidance. Risserné Carole Gabdibé (Team Assistant, World Bank) provided excellent administrative support. Excellent country support was provided to an intensive schedule of visiting missions by the team in BIDPA.

BIDPA wishes to acknowledge the support it received from the African Capacity Building Foundation (ACBF) for both its participation in the research activities that led to the production of this book as well as part funding the publication costs of the book. We are also grateful to Dr Imogen Mogotsi for proof reading the manuscript.

EXECUTIVE SUMMARY AND ACTION MATRIX

Introduction

Botswana stands out as a successful mineral exporting country in Sub-Saharan Africa

1 Real GDP per capita has increased ten-fold since Independence – the fastest growth rate in GDP per capita in the world. When Botswana achieved Independence in 1966 it had 12 kilometres of paved road, 22 Batswana who had graduated from University and 100 from secondary school. Botswana is now classified as an upper middle-income country, and has approximately 7000 kilometres of tarred roads, a GDP per capita in 2003 of approximately US$4000, almost universal free education, three doctors per thousand population, and infant mortality of approximately 58 per 1000 live births. The proportion of the population that has completed primary education has grown from 1.5 percent in 1964 to 33 percent. Botswana was awarded the highest sovereign credit rating in Africa by both Moody's and Standard and Poor's in 2002, 2003 and 2004.

2 Botswana has transformed itself from a largely agrarian and beef exporting country to an economy based on mining exports, the service sector and the government sector. This was achieved because a combination of effective institutions, political stability and sound economic policies allowed it to successfully harvest a natural resource abundance in diamonds – Botswana has become the second largest diamond producer by volume in the world after Australia, and the largest producer in terms of output value (EIU, 2004a).

However, Botswana still faces a number of development challenges

3 First, Botswana has one of the highest HIV infection rates in the world, estimated in 2002 to be 25 percent for those aged 15-49 years. Second, although poverty has declined considerably, about one-third of the population still lives below the poverty datum line and inequality levels are comparable to Colombia and Brazil. Third, diversifying the economy beyond Botswana's principal export – diamonds – is a major policy goal for Government, but is proving difficult to achieve. This is the focus of this study.

This concentration of export activity in diamonds features in most indicators of economic diversity

4 Rough gem diamonds dominate exports, accounting for 83 percent of total merchandise goods exports in 2003. Since the mid-1980s to the late 1990s, the share of diamonds in total merchandise exports averaged 75 percent a year. In recent years, the share has increased to 84 percent as non-diamond exports failed to keep pace with diamond growth. Mineral taxes and royalties are projected to account for approximately 46 percent of total government revenues in budget year 2003/04 and 48 percent in the 2005/06 budget. Seventy-five percent of the stock of FDI in 1999 was concentrated in the mining sector (UNCTAD, 2003). Mining accounted for 35 percent of total GDP in 2002/03, although GDP figures may understate the contribution of mining to economic activity – mining revenues sustain government finances, and public sector consumption equals 37 percent of GDP. General government accounts for 16 percent of GDP, the second largest component of economic activity after mining. Similarly, although diamond-mining represents a relatively small share of employment (3.4 percent), high diamond revenues have allowed a rapid expansion in direct and indirect government employment since Independence.

5 One positive aspect of export diversification relates to trade in services. Services exports have been rising steadily, with an average annual growth rate of around 10 percent in real terms between 1990 and 2003 compared to 3 percent a year for goods exports. This was driven in part by a growth in tourism revenues and business services. Export diversification, therefore, appears to be taking place in the form of a growth in services exports rather than a shift from diamonds to manufactured exports.

Diamond production has conferred enormous benefits to Botswana, although the old adage that "there is no rose without thorns" applies…

6 First and foremost, diamond production creates few direct jobs, skills or technology transfer, accounting for about 3 percent of formal employment in 2001. Unemployment remains high, estimated at around 20 percent of the labour force in the 2001 census and almost 24 percent in the 2002/03 HIES. Second, there are high price and demand uncertainties in the diamond market. Third, there are questions over whether Botswana's diamond output growth can be sustained - open cast mining is projected to last about another 25 years at current extraction rates although new sources may well appear. Fourth, the government budget relies heavily on unstable diamond revenues denominated in US dollars, and has finally moved into a long-awaited (small) deficit. After facing large budget surpluses for most of the 1980s and 90s, Botswana has had budget deficits in three of the last five years. Mineral taxes and royalties (mainly diamonds) accounted for approximately 46 percent of total government revenues and grants in 2002/03.

Key Findings

What should be the policy response in the face of a hugely profitable dominant export sector and the above challenges?

7 This study does not treat export diversification as an enclave issue that is somehow disconnected from the rest of the economy. For example, reform of Government monopolies in telecommunications and air travel is not a new issue. However, we present new evidence on its impact on export diversification, particularly on tourism and financial services. Hence, instead of one 'magic bullet' or hidden growth sector, the study argues that there are a wide number of policy-related constraints to export growth. The removal of these will in aggregate have a significant impact on exports.

8 Key recommendations that require action at the national, regional and international level are as follows:

- At the **national** level there are many areas where government leadership is necessary to improve the competitiveness of Botswana's exports and to help mobilize a supply response. This includes further improvements to the business environment through full implementation of the FIAS (2004) recommendations. In addition, Government should introduce better and more systematic monitoring of its various incentives programs. Government should adopt best-practice principles for citizen empowerment policies so that this policy thrust does not contradict export diversification objectives. The Government review of taxation policies planned for 2005 should include consideration of adopting a flat-rate company tax. There should be a comprehensive reform of Vocational and Educational Training, and urgent resolution of the work permits issue.

  Reform of utilities would reduce business costs and improve the competitiveness of goods and services exports. Government should revitalise its privatization and utilities reform program – particularly in the area of telecoms and air transport. Progress made with the phased agreement towards open skies should be closely monitored to ensure that it gets implemented within the agreed time frames, if not sooner. To reduce international telecommunications prices, Government should consider instructing Botswana Telecom Authority (BTA) to issue an unlimited number of licences for international voice services and lift the ban on providing voice over internet protocol. The monopoly of Botswana Telecommunications Corporation should not be allowed to continue indefinitely to allow BTC to restructure - Government should set a target date for the privatization of BTC.

Some aspects of trade policy are also under the sole authority of national policymakers. The Botswana authorities should refrain from using import bans as a tool to sustain local enterprises against foreign competition. Further, they should undertake a detailed review of all import permits, with a view to removing this requirement for all but a limited number of commodities for security, public health and public morality reasons.

In the face of market failures and policy distortions at the **sector/industry level**, greater Government leadership is also needed to ensure that the right incentives, market structure and capacity-development for growth are in place. In the beef sector, the upcoming Government livestock study should fully consider options for BMC privatisation, the removal of export monopoly (in particular to South Africa) and the potential for trade liberalisation to increase exports. The ostrich sector is still in a fledgling state, and Government should eliminate the current ostrich export levy. Greater government support to the tourism sector is needed, including better marketing, a move away from the current low volume/high cost approach, greater collaboration with private sector organisations including consideration of a formal partnership agreement between the public and private sector, and greater coordination between the Botswana Tourism Board and the Department of Wildlife and National Parks (DWNP). In the financial sector Government should consider broadening the incentives available to IFSC companies to all cross-border services, and making further efforts to streamline the incentives approval process. The textile sector requires an active role for BEDIA to encourage much-needed productivity improvements.

- At the **regional** level the report advocates further regional integration (see paragraph 40) and market opening. This includes Botswana using its potential new influence in the new SACU Secretariat to reenergize the liberalization efforts of SACU. This effort should comprise: a phased program of tariff reforms that would continue the progress made during the early liberalization period in the 1990s, continued reductions in the number of anti-dumping initiations, and developing a regional approach to easing visa restrictions over the longer run. In addition, Government should develop a 'Standards Strategy', to include an assessment of the scope for greater harmonisation of standards within SACU – in particular whether it would be feasible to introduce a single set of standards across the region, with inspections to be done by single authority with clear guidelines of why inspections are being done. Botswana should lobby for simplified and liberalised SADC rules of origin in the SADC MTR follow-up discussions.

Many of the recommendations aimed at improved trade facilitation require a coordinated SACU solution (with some exceptions, such as opening the Tlokweng border gate on a 24 hour basis). Government should develop a program for VAT harmonisation by SACU members. Further, Government should explore the concept of a 'one-stop border post' with South Africa to reduce border crossing time, with a longer-run objective of establishing a regional SACU customs authority Customs and Excise. Government should explore the scope for the introduction of a single tourist visa for multi-country visits to the region, and undertake a review of restrictive cabotage laws that raise freight costs across the region. A new transport desk could be established in the SACU Secretariat that could, for example, tackle intra-SACU transport issues such as accusations of monopoly pricing by South African railways affecting Botswana's exports.

- At the **international** level, continued progress in WTO negotiations and access to EU and US markets are essential. This includes improving EU preferences for beef products to allow customs duty, quota and special duty free export of a wider range of beef and meat products, without excessive administrative and sanitary restrictions. Further, making the AGOA LDC provision permanent would provide predictability for potential investors in a particularly unstable market. Botswana should lobby for improved rules of origin in all preferential trading agreements – in particular, for Economic Partnership Agreement with the EU to allow for single transformation of goods such as found in the AGOA agreement with the United States. Potential new WTO rules on the Doha Development Agenda could assist in reducing the number of anti-dumping actions launched by and against SACU, and an effective agreement on trade facilitation could help to reduce restrictions across the region.

9 Detailed recommendations are presented below. For ease of reference, these are summarized in the Action Matrix presented at the end of this Executive Summary.

<u>The National Policy Framework</u>

Despite a broadly private-sector friendly overall policy environment there are some remaining constraints to business and foreign investment…

10 FIAS (2003) identified delays and inefficiencies in the registration of companies. UNCTAD (2003) expressed concerns over a draft Investment Code which suggested a possible tightening up on conditions for FDI. UNCTAD (2003) and FIAS (2004) highlight the impact of restrictive work permits for expatriates, and also identified difficulties for foreign investors in acquiring commercial land in Gaborone. It is recommended that Government convene a seminar with key stakeholders to monitor implementation of the recommendations of FIAS 2004 report, finalise revisions to the Industrial Development Act with the intention of simplifying the industrial licensing system, expedite approval of a revised investment code that drops restrictions on smaller-scale FDI, and expedite reforms to the land allocation system.

Adopting best-practice principles on Citizen Economic Empowerment could ensure its coherence with export diversification

11 'Citizen Empowerment' is a term used to describe the valid objective of empowering citizens by enhancing their skills, resources and opportunities to participate in productive enterprises. The Government's citizen economic empowerment strategy includes financial intervention to assist local business activities; enterprise development for citizens; job creation; and training

and education. However, there are also a number of concerns about current and potential restrictions arising under the remit of citizen empowerment. Citizen economic empowerment has driven a wide number of Government schemes, including the local procurement program and the reservation policy, concerns over which are discussed below. Further, there are risks to Citizen Economic Empowerment becoming a form of hidden protectionism in its influence on economic policy. Considerations over citizen empowerment may explain some of the delays in dealing with the most pressing economic reform issues identified in this and other recent reports on Botswana, such as land allocation, work permits and privatisation. For example, the initial acquisition of serviced industrial land on state land is restricted to citizens, resulting in major delays for overseas investors in obtaining land. It is important that government policies learn from international best-practice in empowering citizens – the approach taken to citizen empowerment in other countries such as South Africa may not be the most appropriate for Botswana because of the latter's unique historical circumstances

12 This is clearly a sensitive issue that will have a major impact on export diversification. One possible first step towards resolving such conflicts would be for Government to adopt some best-practice principles for actions taken under the citizen empowerment remit – Chapter 2 suggests some possible principles, including principles such as "over-protection and excessive handholding do not lead to empowerment", "citizenship does not convey the right to be shielded from the consequences of making economic decisions", "creating new jobs leads to more citizen economic empowerment than providing preferential treatment for citizens in filling existing jobs", and that "education is a fundamental empowerment tool".

Also at the national level, a unified flat-rate company tax could remove distortions against some export sectors and simplify the regulation of IFSC companies…

13 Botswana is a low-tax jurisdiction, with low general rates of tax and investment tax credits in various forms, including the ability to grant a tax holiday, favourable tax rates or exemption and special deductions for employment or training. Preferential tax rates apply to the manufacturing sector and to offshore financial services companies approved by the IFSC – the company income tax for manufacturing businesses and IFSC companies is reduced from the standard 25 percent to 15 percent. Government can provide company-specific tax concessions, but rarely makes use of this facility. It is recommended that Government considers adopting a uniform 15 percent tax rate for all business activities. This would remove the implicit discrimination against the tourism sector, and would eliminate the onshore and offshore distinction in financial services for tax purposes. This would of course require an assessment of fiscal impacts – non-mineral income tax, which includes personal income taxes as well, accounts for about fifteen percent of total government revenue. As an interim measure, consideration should be given to reducing the transaction cost of applying for the reduced manufacturing tax rate by awarding it automatically, subject to *ex post* oversight. Since tax rates should be assessed in the broad context of macroeconomic management and the overall taxation structure, this should be considered in the context of the overall assessment of taxation policy planned for 2005.

There should be better monitoring of incentive programs, some of which may have an anti-export bias…

14 The Central Statistical Office or another suitable agency or think-tank should conduct a review of ongoing impact assessment and monitoring of existing government support programs, tax incentives and reservation policies, in particular those supporting non-tradeable activities. The reservation policy, through which certain economic activities are reserved

exclusively for citizens and companies which are wholly owned by citizens, should be reviewed to assess whether it has had an impact on building human capital, and whether this offsets its negative impact on consumers by restricting trade and investment. Further, CEDA should prepare more thorough evaluations of project proposals with a view to their net benefit to Botswana, using shadow prices that place a premium on tradeable goods. Government should commission a cost-benefit review of the industrial rebate for raw materials imported for production for sales into domestic market.

15 Recent programs such as the local procurement program and the reservation policy, which typically include small-scale business activities and non-tradeable activities (e.g., housing and personal services), constitute an anti-export bias. The procurement program enables companies to seek protected government contracts instead of local entrepreneurship being directed towards export contracts. However, it is difficult to calculate the extent of the anti-export bias of these schemes. More broadly, it has not been possible to undertake even simple financial cost-benefit analyses of the impact of Government incentives, in part because there is little data collected with which to undertake such analyses.

Import tariff exemption schemes for exporters are well-functioning although they are a second-best option and require some reforms...

16 Botswana exempts certain customs and excise duties and VAT on raw materials imported by registered manufacturers. Various exemption schemes function effectively with few unnecessary delays imposed on importers. They are covered by SACU rules, hence until recently they were determined by South Africa with little consultation or predictability with respect to rules changes. However, although most machinery inputs have zero tariffs and have VAT payments reimbursed, there are still a number of tariffs that fall outside of the definition of ‘raw materials’ or ‘machinery’ that raise the price of operating a goods or service exporting company. Vehicles are one important example. Hence even efficiently-managed exemption schemes are still a blunt instrument to redress the anti-export bias of tariffs. Critically, exporters are not exempted from anti-dumping tariffs on their inputs. Rebates and exemptions are only allowed on ‘schedule 1’ tariffs, whereas anti-dumping duties are ‘schedule 2’ tariffs (see paragraph 46 below). Botswana should propose within SACU that anti-dumping tariffs be eligible for duty exemptions and rebate schemes. With a view to assessing whether there is any practical value to establishing an EPZ, there should be a follow-up review on whether broadening the definition of inputs that are exempt from customs and VAT would make a significant cost difference to exporters.

Export Promotion and Private Sector Support Institutions are well-resourced but are still developing

17 Botswana has a broad range of export promotion activities. BEDIA is refocusing its activities on export development in contrast to export promotion, based on a perception that weak internal capacity for product development is the major constraint to export. In this context, BEDIA is preparing an export development programme as part of the WTO-UNCTAD-ITC Joint Integrated Technical Assistance Programme (JITAP) II. BEDIA and the Botswana Development Corporation (BDC) are both involved in the provision of factory shells. Given the emergence of private sector providers, this should be reappraised. There have been a number of complaints about the effectiveness of the Ministry of Trade and Industry (MTI) in providing political risk insurance – Government should conduct a performance audit of the provision of political risk insurance, including an assessment of need. There are mixed views concerning whether there is sufficient provision of trade

finance and export credit insurance. Smaller export enterprises have reported difficulties in accessing trade credit in a timely fashion. FIAS (2004) made suggestions on minor adjustments to the system that would facilitate a more rapid payment of exporters – these should be implemented.

There are relatively few self-imposed licensing restrictions on exports from Botswana, although there is a need to develop a clearer standards strategy…

18 With the exception of diamonds and beef, Botswana allows exports to go largely unhindered. All commercial exports require an Export Declaration Form, although these are straightforward to obtain. There has been a rapid increase in the number of approved standards – from 30 to 167 between 1998-2002. The Botswana Bureau of Standards (BOBS) is facing a number of challenges. It has limited testing facilities, is not able to implement border controls to monitor the quality of trans-border goods because of the absence of a holding facility, and legislation of departments linked with BOBS is not yet harmonized in terms of the development of product specifications. Government should develop a 'Standards Strategy'. This should include an assessment for the scope for greater harmonisation of standards within SACU – in particular, whether it would be feasible to introduce a single set of standards across the region, with inspections to be done by a single authority with clear guidelines of why inspections are being undertaken. Under Article 28 of the new SACU agreement Botswana and other members have agreed that "Member States shall strive to harmonize product standards and technical regulations within the Common Customs Area". A priority for the new SACU Secretariat will be to give some clarity and a roadmap on how Members could achieve this goal. BOBS is already collaborating with SADC countries to develop a regional body for accreditation of conformity assessment facilities (SADCA), which would allow mutual recognition among all members. Such measures to avoid duplication should be encouraged. As Botswana's major market for non-traditional exports and a major source for international exports, continued cooperation with the South African Bureau of Standards is essential.

Human capital needs to be increased to boost productivity, in particular through a reform of the vocational and educational training system and a resolution of the work permits issue…

19 This study conducted a survey of 11 exporting firms to discuss a wide range of labour-related issues. Botswana now has a well-resourced education system, although there are two particular areas of concern. First, in the absence of any systematic human resource planning, Botswana's vocational training system has been supply-driven with relatively limited involvement of employers in the development of course content and training standards. It focuses mainly on pre-employment, time-bound technician and craft-level skills training for predominantly male primary and secondary school leavers at government-funded vocational training centres. There is a skill mis-match between this training and the skill needs of manufacturing and other key sectors, which rely almost totally on on-the-job training for both production workers and other staff. Training policy and practice is still too compartmentalised between the Botswana Training Authority (BOTA), the Tertiary Education Council (TEC), and the Ministry of Education. It is recommended that Government develop a detailed and comprehensive national human resources development strategy, which focuses in particular on the occupational requirements of the key growth sectors in the economy. This should include a comprehensive reform of the vocational education and training (VET) sector. In particular, little use is made of the company tax

rebate for training, with companies complaining that it is too bureaucratic. This requires reviewing and replacing it with a more effective incentive for human resource development.

20 Second, obtaining work and residence permits has been consistently identified as among the most difficult investment procedures in Botswana. The total backlog of work permit applications was 7474 in late 2004. Temporary work permit waivers enable most foreign investors to circumvent unwieldy and bureaucratic work permit procedures, although these have to be renewed every three months. A resolution of the work permits issue is required, possibly with permits based on a points system and/or a minimum number of permits awarded automatically for companies. Of particular concern is between 600-1000 percent increase in work permit fees over the last four years and the twenty-fold increase in visa application fees instituted in 2004. Government should review these cost increases. Producers have complained that this has unreasonably raised the costs of obtaining labour. Advanced economies such as the United States still require the importation of large numbers of expatriate experts – Botswana's stage of development and limited labour pool suggests that it should be encouraging rather than discouraging the arrival of skilled immigrants.

The Role of Government at the Sector and Industry Level – the Case Studies

21 Government leadership is needed at the sector level to ensure that the right incentives, market structure and capacity-development for growth are in place.

The beef sector faces growing competition and a need for reform…

22 This study commissioned a background study on the beef sector. The Botswana beef export industry is in crisis. The recent financial difficulties of the Botswana Meat Commission (BMC) – the Government's export monopoly for beef – have been exacerbated by temporary factors – notably the recent drought and the outbreak of foot and mouth disease (FMD). But while there may well be a cyclical upturn, these cycles are nevertheless occurring around a deteriorating trend. Further, in the past frequent exchange rate depreciations against European currencies in most years allowed BMC to post regular profits – this has recently been reversed as the exchange rate appreciates.

23 This trend will not be reversed without fundamental change that would increase the number of cattle sold to BMC for export. There appears to be a consensus that the fundamental problem facing the sector is that the cattle off-take rate is too low. This results in poor throughput (and low weights) for BMC, either because prices on the domestic market are pushed up, making it more attractive than exporting, or simply because there are too few cattle raised with the intention of bringing them to the market. Various studies suggest that there is significant scope for an increase in supply. However, over the period since 1992 prices paid to producers have generally gone up by less than the price paid by EU importers. This has occurred for a number of reasons – high costs arising from EU SPS measures and rising demand in the local market, resulting in fewer cattle being sold to BMC and hence higher unit processing costs.

24 The beef sector has long been a recipient of government support in the form of artificially high producer prices, heavy direct subsidies into the sector, a very lenient tax system, heavy provision of livestock-specific infrastructure and trade protection. Industry restructuring would allow time for either a substantial shake-up to the supply side or an orderly decline of the beef export sector. The study cautions against precipitate moves to privatise BMC – at least until the supply side has been improved. The supply baseline is a throughput sufficient

for only one abattoir, and standards might be compromised. Another option that should be considered is continuing BMC's monopoly in terms of exports to Europe and other distant markets, but its removal for sales to South Africa. At the present time it seems improbable that any organisation other than BMC would sustain substantial exports outside the region. If Government decides that maintaining the export market is preferable to a domestic-only beef market, there should be further consideration of the scope for liberalization of beef imports. This would reduce domestic prices, making selling to BMC for export more attractive for farmers. In the industrial sector and advanced countries it is commonplace to have intra-industry trade – there is no reason in principle why the same should not occur in Botswana, with the region importing larger quantities of forequarter meat partly in order to release hindquarter meat for export. The planned livestock study should provide a clear estimate of the number of cattle in the country. Better information is essential for policymakers – it would help to clarify issues such as off-take potential, linkages and the importance of cattle to the Botswana economy.

The ostrich sector is still at a nascent stage, during which time the removal of the export levy should be considered…

25 The Botswana ostrich industry is at an infant stage. There are currently about 29 active farmers in the country, holding a total of about 500 breeding hens. About half of these ostriches are held by two large scale producers. In terms of production efficiency, the Botswana industry produces a heavier bird in a relatively shorter space of time than South Africa, although the overall quality of the skin is poor. There is only one abattoir, managed by the Botswana Ostrich Company (BOC). This received certification for exporting directly to the EU in August 2004. Since then, the BOC has been able to supply around 3 tons per month to the wholesale trade in Belgium. There is optimism that exports can be increased to the EU, the target market. There is no tannery for ostrich leather as yet.

26 The government has supported Botswana's ostrich industry through the provision of a new state-funded ostrich abattoir and veterinary services, and through its willingness to extend BDC loan facilities despite a failure to repay the initial loan on schedule. The success of the ostrich industry depends upon the viability of the BOC as the sole marketing channel for ostrich products in Botswana. BOC is currently running at a loss, but is hopeful for a positive supply response from both existing and new producers following the approval to export to the EU market. The key issue for Government is for how long to subsidise this industry – there should not be an assumption that just because the country has the largest population of wild ostriches in the world it is automatically suitable for effective farming. There is significant growth potential, but there should be a clear end-point for the current public subsidy. However, it is premature for the imposition of the current export levy of P32 on average per bird, which reduces BOC's earning by about ten percent per bird. Government should eliminate this levy until the industry reaches a critical mass to attain BOC profitability. According to industry participants, CEDA has so far not been sufficiently forthcoming in funding ostrich farming projects. Only 10 ostrich projects have so far been approved for funding, with none since the EU granted export approval. CEDA's reticence may well be based on valid financial reasons, hence this issue should be addressed and negotiated at an industry level.

The tourism sector has major potential but requires greater investment and a clearer voice in policymaking…

27 Apart from its diamonds and beef, Botswana's natural comparative advantage is in its diverse and abundant wildlife and natural resources, which are a major draw for tourism. Tourist numbers rose rapidly but peaked in 2000. The gradual decline seen in 2004 – set against a net increase in South African tourist numbers – is of serious concern. Nevertheless, the sector has significant growth potential.

28 Botswana's Tourism Policy has generally been based on sound principles that have acknowledged the environmental value and vulnerability of the resource base. However, there is a need to give greater recognition to the sector in policymaking, and to align the sector support institutions more clearly around a demand-led approach. Further, despite the Government's policy objective of "modified high volume/mixed price" tourism, Botswana is still largely a low volume/high cost destination. Botswana can sustain its national wilderness areas while increasing visitor numbers. Government should consider greater 'zoning' of wildlife areas to allow higher volumes in certain areas while maintaining greater restrictions in others. The independent, self drive component of the international tourism market is growing continuously – the sector should develop the required infrastructure and marketing packages to capitalize on this segment of the market.

29 While the various tourism policy frameworks provide some excellent proposals, these are not part of a clearly defined and prioritized implementation plan, with the result that it is difficult to gauge and monitor implementation. The Department of Tourism (DoT) suffers from a lack of adequate funding and a clear competitive marketing strategy, and has to play the role of "referee and player" by having to regulate the industry while promoting it. Government should allocate and manage the budget allocation and investment for the DoT and the Department of Wildlife and National Parks (DWNP) as a whole package within a commonly agreed tourism development strategy. Due to limited resources and capacity, the promotion of "Brand Botswana" as a global destination of choice has suffered during the past few years and marketing has been largely left to the private sector. The recent appointment of the first Botswana Tourism Board bodes well for destination marketing. There is need for a well-researched, clear marketing strategy that will direct the future marketing focus of the Board and will inform Botswana's overall tourism policy and development thrust.

30 An adherence to low volume/high value tourism and limited budgetary allocations have led to under-investment in essential facilities and infrastructure development for tourism, and mounting pressure is being placed on the existing and limited infrastructure of wilderness parks (in particular Chobe). A formal partnership agreement between the government and the private sector should be considered, possibly based around a dedicated Tourism and Conservation Management Fund. The establishment of local tourism associations in the main tourism centres, affiliated to Hotel and Tourism Association of Botswana (HATAB), should also be considered. Such partnerships should aim to strengthen linkages to the local economy. Further research is needed on the costs and benefits of allowing a longer concession term for tourism leases in wildlife management areas.

The International Financial Services Sector must be underpinned by sound regulation while incentives should be broadened to all services exports…

31 The Botswana International Financial Services Centre (IFSC) became operational in 2000. IFSC has managed to attract twenty-one companies in a relatively short time. IFSC

companies are estimated to grow to 244 total employees, of whom 168 are local, in 2005. Unfortunately there are no available data to isolate the impact of the IFSC upon the services trade balance.

32 Botswana offers a generous incentives package in its endeavour to set up an international financial services centre, including a reduced corporation tax regime stabilized to 2020, exemption from VAT on services or imports, and a credit for withholding taxes levied in other jurisdictions. All services must be for clients based outside of Botswana and transacted in foreign currency.

33 There are two main sector-specific challenges. First, a necessary condition for an international financial centre is to have a modern and well respected regulatory framework. A background study on the financial sector prepared for this report concluded that the regulatory system has so far been in a rather reactionary posture to new developments and has tried to accommodate new needs within an existing structure. Government should make further efforts to streamline the process of obtaining IFSC tax and regulatory approval and reducing the number of bodies involved (currently the IFSC, the MFDP and the Bank of Botswana) through introducing a one-step approval process. A potential problem arises from having a dual tax regime, marketing an offshore jurisdiction based on a two-tiered tax regime (i.e., one for domestic economy and another for offshore) is becoming increasingly difficult. An overhaul of regulation of the non-bank financial system, including the offshore jurisdiction, is necessary. Further, a key enabling factor for financial services exports is the number of double-taxation agreements – Botswana has only ten such agreements, compared to 40 in Mauritius. Government should increase efforts to negotiate double taxation agreements.

34 Second, Government should reappraise the existing scope of companies eligible for IFSC incentives – its current focus is too narrow and excludes a number of potential cross-border service activities (e.g., regional transport companies). Government should consider broadening IFSC incentives by making all cross-border service exporters eligible for incentives and renaming the 'IFSC' (International Financial Services Centre) the 'ISC' (International Services Centre).

The textile and apparel sector faces a challenging environment, and there is a clear role for BEDIA to initiate industry reform to improve productivity

35 Botswana's textile and apparel industry faces a number of challenges – notably the phase-out of the multi-fibre agreement, the possible ending of special access to the US market, and the ending of the Financial Assistance Policy (FAP) subsidies. Despite this, its relatively diverse apparel exports have been growing rapidly to the United States (the 'AGOA effect'), although exports to South Africa and Europe, while on a growth trend, both dipped in 2004 according to preliminary government trade statistics.

36 Government has made extensive use of subsidies and other tax incentives to develop the textiles and apparel industry. The main subsidy – the Financial Assistance Policy (the FAP) – has ceased and subsidy payments will end in 2005. While the industry may be able to survive without cash incentives, it will flourish only if sector efficiency is increased and only in an environment where the economy-wide barriers to conducting business discussed in this report are removed. The primary threat to the industry is its lack of competitiveness in terms of factory efficiency – productivity levels are very low, with the best examples estimated to

be 50 percent of established international standards. This is because of inadequately trained operators and a lack of control by supervisory management.

37 There is a clear role for the Botswana Export Development and Investment Authority (BEDIA) in developing a comprehensive response to this lack of productivity. They should commission productivity audits and training needs analyses, identify suitable service providers to address the needs of the industry both nationally and regionally, identify means of financing productivity enhancement and training, and develop the market for training service providers to the industry. BEDIA should facilitate the establishment of an association of Botswana Textile and Apparel manufacturers as an independent and officially registered body. There is also a need to identify niche markets. BEDIA should focus its promotion effort on suppliers to specific market segments that can create competitive Botswana-based supply chains. The most likely market segments are Formal Modern Niche markets in Europe, the USA and South Africa, the replenishment segment of Traditional and Modern Mass markets in Europe, USA and South Africa, and South African based apparel manufacturers supplying the potential future Zimbabwe market.

The Automotive products sector is fairly dependent on the continuation of the South African Motor Industry Development Programme (the MIDP) and tariff protection…

38 Exports surged between 1996 and 2000 because of the establishment of a large Hyundai assembly plant in Botswana. This plant closed in 2000 ostensibly because of market access barriers and poor management. Rules of origin played a role in its demise. After the plant started operations South Africa challenged that there was insufficient value-addition taking place and ruled that the products failed the rules of origin requirements as originating from Botswana. South Africa used SACU Article 11(5) to oblige Botswana to cooperate in the fulfilment of 'economic objectives' of its import control legislation for the auto sector.

39 A fledgling automotive products sector remains. This sector evolved through generous FAP incentives, the MIDP program and high tariff protection in the SACU market. Of the five firms surveyed for this report, two (the majority by output) benefit from MIDP, while the remaining firms sell to the tariff-protected SACU market (accounting for about one-quarter of employment of the firms surveyed). Further, three firms benefit from (soon to be phased out) FAP subsidies. Tariffs in SACU are currently 38 percent for cars, and are scheduled to fall to 28 percent by 2009. Automotive products companies, therefore, face a challenging future. The MIDP provides a large reduction in import duties on completely built up units for exporting companies, and has been a facilitating factor in choosing South Africa as an assembling centre by western and Japanese automobile giants. This scheme is potentially open to WTO challenge as an export subsidy. This would reduce the attractiveness as a location for assembling and manufacturing components for export in future. Beyond maintaining protection at the expense of consumers and business users of transport – which this study does not recommend – there were no export constraints specific to this sector identified in the background study.

A Case for Greater Regional Integration

A major cross-cutting theme of the report is the need for greater regional integration…

40 Government should develop a clear long-term vision based on a transformation of SACU from a customs union to a single market. The new SACU Agreement, renegotiated in 2002, falls well short of a bold new vision for further regional integration. It maintains the basic

customs union with very limited aspirations towards a single market. The Agreement excludes cooperation on investment protection and incentives, but does include an agreement "in principle to develop common policies and strategies". Similarly there is no commitment to develop a common competition policy, although there is a commitment for Member States to cooperate on the enforcement of competition laws and regulations. There is no provision to allow for the freer movement of people. Services remain outside of the agreement. However, the report identified a wide number of issues that need to be resolved at the regional level (see paragraph 8).

41 A Customs Union, such as SACU, requires a common external tariff, a customs pool and a common trade policy. However, fiscal borders have remained in place and border controls are maintained for differences in standards (e.g., safety standards). In contrast, a single market means that goods circulate freely, with a common trade policy, the harmonisation of standards, common policies in competition, and harmonization of regulations where there is substantial intervention in the market.

42 South Africa is the regional superpower, accounting for 90 percent of SACU's GDP. As the dominant regional economy it has a past record of setting trade and economic cooperation policy according to its own interests with little consultation with its smaller neighbours. This has led to fears over the pooling of sovereignty associated with closer economic integration. However, this report advocates deeper economic integration in SACU, based on the concept of "open regionalism" (GEP 2005) where barriers are also reduced between the region and the outside world. Recommendations for closer integration feature in most sections of this report, as summarized in paragraph 8. This is for the following reasons:

- ***First, Botswana cannot 'go it alone' given its small population.*** South Africa is likely to remain the major market for its non-diamond exports because of high transport costs and the trading benefits of proximity. Apart from Egypt, South Africa is the only major market in the region. The use of import substitution in the region to promote demand for more advanced products is not good, and small countries have had particular difficulties in using such techniques because of their small market size. A small domestic market size is also a major constraint to investment since it limits the scope for economies of scale and expansion. A survey of French companies found small market size to be the main factor limiting investment in Africa (Charalambides, 2004). Trade ties with South Africa have played a central role in the development of Botswana. South Africa is the primary market for Botswana's non-traditional exports, constituting 75 percent of non-traditional exports. The case studies for this report suggest a mixed reliance on the South African market. Fifteen percent of beef exports are destined for South Africa, although this may represent a more important market as preferences to the EU are eroded. All ostrich exports are destined for the EU. Data is not available on financial services direction of exports. Over half of holiday visitors come from South Africa. South Africa has traditionally been the dominant market for textiles and apparel exports.

- ***Second, although Botswana has a higher GDP per capita than South Africa, it can still benefit from South Africa's more developed private sector, market know-how, expertise and investment.*** South Africa is the source of almost half of the stock of FDI in Botswana. Investors from outside the African continent are so far mainly interested in minerals. Attracting high quality investors who actually understand the international market is a challenge given that the economy of the entire SACU region is still approximately the size of Belgium's economy. Recent surveys of South

African investment in Africa indicate that familiarity and the need to use South Africa as the "anchor" economy are important determinants of investment (Charalambides, 2004). In some sectors, for example the textile or automotive products sectors, South Africa offers the potential to link into regional supply chains, although progress in developing such linkages has been limited to date.

- ***Third, the harmonization of regulations required to move towards a single market could act as a major spur to increased investment and trade within the SACU region and beyond.*** It would ultimately remove the need for the customs control of goods at the border, would encourage inwards investment to the region (since investors would have a common rules platform), and would encourage greater cross-border competition in services. As argued throughout the report, without such cooperation the impact of having a customs union with a common external tariff is limited. The European Union did not have free circulation of goods before the single market: "Despite the absence of customs duties in trade between Member States, in fact there was little difference in administrative burden or appearances between intra – Community trade and trade with non – member countries… Customs clearance at the Community's internal frontiers was elaborate and time consuming" (European Commission, 1999). Of course, this is not a rapid process – it took the EU thirty years to harmonize its non-tariff barriers. Further, the liberalization of movement in people would also be beneficial to labour markets within the region, and could take place at a pace acceptable to SACU members, given concerns over its impacts. In the EU, regulations liberalizing the movement of people were introduced after the liberalization of goods.

- ***Fourth, there is not a choice between aligning Botswana with Europe, North America or South Africa.*** Closer integration with South Africa would not be at the expense of closer trade and investment ties with other regional partners and beyond. "Trade diversion" costs should not be exaggerated – tariffs can be a small part of the importing decision in relation to other costs (see Box 4-4). Nevertheless, closer regional integration should be accompanied by continued reductions in high external tariff walls (Hinkle, 2004).

<u>Trade Policy – Actions at the National and Regional Level</u>

Import tariffs are moderate, although there is still a need to reduce protection and simplify the tariff structure

43 A key feature of the SACU common external tariff (CET) is high tariff dispersion, from 0 to 325 percent with a simple average tariff of 8 percent and an import weighted average of 6 percent, a cascading tariff and a high tariff variance. This increases effective rates of protection and inefficiencies. A combination of high and low tariff rates reflects a South African policy of keeping input tariffs low and maintaining high tariffs on some final products. Botswana should initiate a renewed program of trade reforms through the new SACU Secretariat. This should include a phased program of tariff reforms that would continue the progress made during the early liberalization period in the 1990s, and would include SACU accelerating its tariff rationalization program to reduce the number of tariff categories from 41 to six, in line with WTO commitments. SACU tariffs largely protect South African industries at the expense of Batswana consumers and businesses (including exporters – see below). A reduction from over 100 to 41 *ad-volorum* tariff bands has so far

taken place. Less complexity would increase transparency, reduce the scope for protectionist lobbying, and therefore facilitate trade.

44 SACU tariffs provide relatively high effective protection to some industries. Using standard tariff analysis, tariffs raised the incentives for Botswana companies to serve the domestic SACU market above the world market by raising the profitability of doing so by on average 88 percent for a sample of 33 firms surveyed in Botswana by The Services Group (TSG, 2003). The most protected sectors according to the TSG analysis are food processing, textiles, clothing, wood products and furniture production.

45 Botswana should use its influence in the new SACU Secretariat to reenergize the liberalization efforts of SACU. This effort should include tariff and non-tariff measures that feature throughout this study. On tariffs, this should include a phased program of tariff reforms that would continue the progress made during the early liberalization period in the 1990s. This would focus on reducing SACU's average applied rates (which would be strongly in Botswana's interest), urging SACU to accelerate its tariff rationalization program to reduce the number of tariff categories, lobbying within SACU for the number of anti-dumping initiations to be further reduced, and reviewing the impact of liberalizing beef imports with a view to discussing this with SACU neighbours.

Anti-dumping is one of the main 'trade-policy imposed' non-tariff barriers. This could have a significant impact on input costs for some exporters and requires further investigation…

46 On a trade-weighted basis anti-dumping measures add little to overall protection, although they do make a significant difference at the individual product level. Critically for SACU exporters, most of the challenged products are intermediate products in the production process (Holden, 2002). Hence, while intermediate products typically face a lower MFN tariff level, antidumping duties increased this protection considerably in the 1990s. These duties ranged between 15 and 202 percent and averaged 52 percent. Chemicals form the largest single sector for initiated cases (37 percent), and make up approximately 10 percent of Botswana's imports. Similarly, machinery, mechanical and electrical appliances make up a further 9 percent of anti-dumping cases and constitute 19 percent of Botswana's imports. Critically, duty exemptions do not apply to anti-dumping duties. Government should commission a short follow-up research piece to isolate how anti-dumping duties have increased the anti-export bias by raising the input costs for producers. At the same time, Botswana should act within SACU to further reduce the number of anti-dumping initiations and to change SACU duty-exemption rules (see paragraph 16 above). Further, Government could advocate the development of tighter rules on anti-dumping for all WTO members through the WTO Doha Development Agenda.

…while Botswana imposes very restrictive non-tariff barriers on some sensitive products it should refrain from using import bans as a tool to sustain local enterprises against foreign competition.

47 Import bans are an arbitrary measure that is borne by the consumer and contributes to the anti-export bias. Botswana makes use of import licensing and import bans on the imports of some agricultural products (bread, beef, fish produce, eggs, chicken and – when in season – oranges, cabbages, tomatoes, and milk). The limits amount to an import ban for beef, eggs, poultry and bread. Botswana imposed a ban on the importation of bread in October 2003 to support local bakeries. Consumers had hitherto chosen higher-quality imported long-life

bread, but were denied this choice by the ban. More critically for exporters, a further import limitation is being considered at the time of writing which would ban the importation of all second-hand vehicles that are more than five years old. This would be enacted ostensibly on safety grounds, but would more likely be initiated to protect largely South African producers from imports of reconditioned Japanese vehicles.

48 Government should undertake a detailed review of all import permits with a view to removing this requirement for all but a limited number of commodities for security, public health and public morality reasons. In particular, Botswana should avoid any new restrictions on the import of second-hand vehicles. More broadly, the Botswana authorities should ask the new SACU Secretariat to set up a monitoring program of NTBs in similar fashion to a COMESA exercise.

So is there an 'anti-export bias'?

49 Yes, but the economics of being in a customs union complicate the analysis. Import tariffs, and restrictions and regulations do impose a moderate anti-export bias on the economy. However, because high protection has supported industries largely in South Africa rather than Botswana, SACU tariff barriers have had a less distortionary impact on Botswana than might be expected. Botswana is therefore in an unusual position: because of the existence of the SACU customs union, a bias towards domestic production within SACU does not fully translate into a domestic investment bias towards import-competing production for Botswana.

50 Nevertheless, tariff and non-tariff barriers do have some impact on incentives to export from Botswana. First, they reduce consumer welfare and thus national income and investment, although the extent to which tariffs are the principal cause of trade diversion in the region can be disputed (Charalambides, 2004). Second, they have switched demand and therefore investment towards some protected industries in Botswana – textiles and clothing tariffs have raised the price of clothing on the domestic market throughout SACU, making it more profitable to sell into the domestic market and in South Africa. An import ban and a 40 percent external tariff may have had a similar impact in the beef sector, where supplies to BMC for export are too low (see paragraph 24). Flour milling, furniture production, egg production, and dairy production also depend on non-tariff protection. Third, SACU tariffs and national non-tariff barriers raise the cost of inputs used by export companies. The transport sector is a good example. Trucks are not considered as machinery, hence they face tariffs and VAT. Motor vehicles face particularly high tariffs (see Box 3-2). Tariffs on computer equipment were reduced to zero only in 2004 after successive requests by the Botswana authorities. Further, some industrial materials still face tariffs, such as steel which faces a tariff of 5 percent, furniture of approximately 20 percent, transport equipment (approximately 12 percent), and printing and publishing (approximately 7 percent). In addition, anti-dumping duties are passed on to exporters as described above.

Protection of services from foreign and domestic competition also raises business input costs for exporters, and represents a potential negotiating chip…

51 The state retains a monopoly in key utilities and elements of the transport sector: fixed-line telecommunications, water supply and sewerage services, electric power supply, the airline and the railway. The airline and telecommunications represent a major potential improvement to exporter efficiency – tourism operators surveyed for this study consistently identified air transport costs as a major restriction (see recommendations on air transport

reform, paragraph 71). More generally, service companies identify international telecommunications costs as a particular constraint. To reduce international telecommunications prices, Government should consider instructing the Botswana Telecommunications Authority (BTA) to issue an unlimited number of licences for international voice services and to lift the ban on providing voice over internet protocol. The monopoly of BTC should not be allowed to continue indefinitely to allow BTC to restructure – Government should set a target date for the privatisation of BTC.

52 Such reforms could be used as a 'negotiating chip' in regional or WTO trade negotiations. Botswana has committed to under 5 percent of all possible WTO GATS services commitments, which is less than the average developing country index of 6.9 percent (WTO TPR, 2003). There are no GATS commitments on supply of services by temporary movement of people nor (generally) on cross-border trade. This means in some cases that service has to be supplied through commercial presence by a supplier who meets all the normal residency requirements.

Because of various preferential agreements, the levels of external tariffs imposed by trading partners are not a major barrier to export growth.

53 Diamonds are allowed duty-free access to the EU market regardless of the trade regime in place. The vast majority of Botswana's other main products take place under preferential trading arrangements or the SACU customs union, hence face few tariff restrictions.

54 Exports to South Africa and other SACU members enter duty and quota-free. Most exports to the US take place under AGOA. Exports to the EU take place under the Cotonou arrangements, where ACP countries are entitled to a 100 percent reduction in *ad valorem* customs duties. The export weighted MFN tariff facing Botswana's food products to the EU is 55 percent, while the average *applied* tariff is only a 5 percent (CEPII, 2004). CEPII (2004) find that, given a high level of protection on beef carcasses, there is no evidence of tariff escalation for food products. There are currently no import tariffs or export duties on ostrich meat exports to the EU market. Botswana has preferential access to several important markets for garment and textile products. As an ACP country, it has duty and quota-free access for textiles and apparel to the EU. Under AGOA, Botswana qualifies as a 'least-developed country'. This means that until September 2007 it can produce apparel from fabric purchased anywhere in the world and ship it to the United States duty-free. As a SADC country, its products are given preferential duty treatment when exported to SADC countries outside SACU. Zimbabwe and Botswana have a free trade agreement that dates back to 1956.

The erosion of these trade preferences is a concern in a number of sectors

55 Botswana faces the inevitable erosion of its existing preferential market access through the reduction of tariffs and trade barriers under WTO, regional and bilateral trading agreements,.

56 The **textile industry** has faced the phase-out of multi-fibre agreement (MFA), and faces the potential removal of AGOA special preferences after September 2007. With MFA phase-out, major low-cost apparel producing countries, most notably China, are likely to take a greater share of the apparel export market, although it is too early to fully assess the impacts. There is no doubt that some buyers will switch from African suppliers to Asian ones, particularly those in price sensitive markets segments. On the other hand, price is not the only point of competition in apparel: African apparel meeting the rules-of-origin can still be imported

duty-free into the USA and Europe; many buyers do not want to source all their products from a single country or region; and China and other low-cost Asian producers do not have an infinite capacity to expand production.

57 AGOA has been the dominant driving force behind recent growth of the apparel sub-sector in a number of Sub-Saharan African countries, including Botswana. Botswana's AGOA 'LDC status' means that manufacturers are able to source highly competitive Asian manufactured cloth as their raw material input. Currently, this special LDC advantage will expire midway through 2007 and it is unlikely to be extended. This would have the greatest impact on the woven apparel segment of the sub-sector, employing 25 percent of the workforce. The survival of these factories is at risk if they cannot source Sub-Saharan qualifying fabric. Botswana needs to start preparing now for this eventuality. Coping strategies could include shifting market focus away from the USA to other markets, shifting the sourcing of raw material to AGOA eligible countries, reducing manufacturing costs through improved labour and material efficiency and by investing in more automated equipment, and shifting production to apparel made from fabric and yarn that is considered in short-supply in the USA and, therefore, still duty-free to the USA under AGOA.

58 Botswana is protected from full-scale competition with the most efficient producers of **beef** in the world in a small number of markets only, of which the EU and South Africa (plus Norway) are probably the most important. ACP countries are covered by Protocol 4 on beef and veal of the ACP–EU Partnership Agreement of 2000 which gives beef a 92 percent reduction in customs duties. The prospect of price competition pushing EU prices below their current level would be increased greatly if Botswana were to face direct competition with Latin American or Australasian suppliers. At present, Botswana has a preferential tariff quota (TRQ) under Cotonou. Because both the Cotonou and WTO TRQs are small relative to the size of the European market, these imports do not significantly push down prices. The Doha Round or an EU–Mercosur Free Trade Agreement could result in a significant increase in the size of the TRQ for Botswana's competitors, while a merging of EPA and WTO quotas could have the same impact. While the main policy response is an improvement in competitiveness in the beef sector, Botswana should nevertheless push for the EU to widen existing trade preferences for beef products by allowing customs duty, quota and special duty free export of a wider range of beef and meat products.

Non-Tariff Barriers represent a more serious market entry restriction than tariffs, and rules of origin are particularly damaging...

59 For trade with regional neighbours, the more obvious non-tariff barriers (NTBs) – foreign currency controls, import licensing, price controls and state marketing – have been removed, but a number of more non-transparent and arbitrary NTBs remain. For exports outside of SACU, complex rules of origin act as a substantial barrier to exports. The power of rules of origin is apparent from their positive impact in AGOA, and in their negative impact in decreasing Botswana's textiles export to Zimbabwe. Rules of origin have proven to be the most contentious part of implementing the SADC Trade Protocol. Current rules of origin will be very difficult to satisfy for regional producers and will therefore hinder regional vertical integration (Brenton, 2004). Special rules of origin have been applied to certain sectors (e.g., motor vehicles and sugar), and negotiations for other sectors are still ongoing—most notably textiles and apparel, and wheat and flour. For textiles and apparel, imported raw materials will have to undergo a minimum of two stages of production ("double transformation") before they can be considered to have originated in a SADC country. SADC rules of origin on vehicles and components will also make it difficult for Botswana's

small auto sector to sell to non-SACU SADC countries. SADC Member States plan to discuss rules of origin as a follow-up discussion to the Trade Protocol Mid-Term Review.

60 Botswana should launch a concerted lobbying effort to improve rules of origin in all preferential trading agreements, starting with a Government-initiated 'rules of origin' strategy paper. In particular, this could advocate for the Economic Partnership Agreement with the EU to allow for single transformation of goods such as found in the AGOA agreement with the United States. In addition, Botswana should lobby for simplified and liberalised SADC rules of origin in the SADC MTR follow-up discussions (quota restrictions should be removed and the derogation should become the general rule for all SADC Member States). Botswana should press within SACU for a concerted and more liberal approach to rules of origin – SACU has been resistant to relaxing rules of origin within SADC, insisting on higher local content to qualify for preferential treatment than other SADC members would like to accept. Botswana should combine efforts with other textile and garment exporters in the region to lobby for the AGOA LDC provision to be made permanent.

…and the EU's stringent SPS regulations on beef and ostrich exports are becoming ever more troublesome and costly to implement.

61 Compliance with the EU's SPS requirements is necessary not only to continue exporting to Europe, but also to many other high-priced markets for both beef and ostrich sales. Part of the reason for the Botswana Meat Commission's (BMC's) failure to operate at full capacity has been the closures required from time to time to deal with animal disease outbreaks. In the ostrich sector, the BOC also cannot currently isolate and quantify such costs. One of their concerns is that the multi-species abattoir is required by government to meet stringent EU standards for all its slaughter operations, including cattle service slaughters for domestic beef processors. This renders the abattoir less competitive in slaughter service provision relative to its domestic rivals. Detailed estimates of the costs of compliance in both sectors should be a priority for further research so that policymakers may fully assess the costs and benefits of the current emphasis on sales to the European Union.

There are various other non-tariff barriers limiting regional and international exports from Botswana.

62 Import permits are required for agricultural products in most SADC countries. South Africa imposes specific levies on some imported and domestically produced agricultural products, although these are not high. Local content requirements are used in all SACU countries. Visa restrictions increase the cost of travel and business, and have a particular impact on the services sector. There is no provision in the new SACU agreement to allow for the freer movement of people. If SACU is to move towards a single market, this is an important step towards its achievement. Botswana should work with other SACU members to develop a regional approach to easing visa restrictions, starting with a SACU-wide visa, possibly including SADC members.

Trade Facilitation – Actions at the National, Regional and International Level

Botswana faces a number of 'trade facilitation' constraints

63 Key features of Botswana's trade facilitation landscape include proximity to major South African markets, distance from major developed country markets, and – as a landlocked country - reliance on transit through its neighbours, primarily South Africa. Botswana is only four hours by road to the major South African conurbation of Johannesburg. Botswana's

exports to the US and EU largely pass through the Port of Durban, which is just 9 hours journey from Gaborone. The costs of transport links to other countries in the region are raised by poor and fragmented infrastructure in neighbouring countries. High transport costs were quoted as a major constraint for all of the background sector studies conducted for this report. Transportation costs for imports of intermediate and capital inputs and exports from Botswana to South Africa and beyond are high in comparison to international competitors such as Mauritius and South Africa, or Argentina or Brazil for beef.

Shipping costs are expensive from Southern Africa – Government should use its own procurement program to increase competition

64 Naude (2001) estimates that shipping costs from South Africa are significantly above world prices – with the margins on imports almost 50 percent higher than the average for developing countries. Despite a general reduction in shipping costs worldwide over the last three decades, costs from South Africa have risen. Private freight companies suggest that Government, a major importer of goods, does not provide sufficient scrutiny to its transport cost on imports. Government should undertake a review of government-procured shipping costs to assess whether greater price pressures could be introduced into the transport market. This could review whether government should import FOB[1] and open transit to tender from national and international importers. As part of this review, CSO should build an index of shipping costs on which to base analysis ('FOB' and 'CIF' costs).

Walvis Bay and the Trans-Kalahari Corridor offer an alternative route out, but has not yet become popular.

65 By using Walvis Bay, Botswana manufacturers can reduce shipping time to Europe and the East Coast of the United States by a week or more compared to Durban, although the cost is similar. This is particularly important in the apparel sector where a short response time to orders is crucial. This route uses the Trans-Kalahari highway linking Pretoria to Walvis Bay via Botswana. An important component of maritime transport costs is seaport efficiency. South Africa's port turnaround times tend to be up to 5 times as long as that of competitors (Naude, 2001). Port clearance in South Africa on average takes two to three days, and there are many complaints about congestion, especially at the Port of Durban. Container handling at Walvis Bay is more efficient than the port of Durban; and, according to some officials, there is less pilferage of goods. Unfortunately, direct call to the USA has not yet been established, in part because Walvis Bay is not yet certified for export directly to the US. The Walvis Bay route has so far not proved attractive to exporters, partly because traders are accustomed to the Durban route. Hence, traffic to and from the port to Botswana is low, raising transport costs and limiting the frequency of sailings from Walvis Bay. Government should work with the Walvis Bay Corridor Group and other authorities to encourage greater use of Walvis Bay route.

Botswana has a relatively well-developed and well-managed land transport infrastructure, although costs could be reduced through removing cabotage cartage laws and reviewing road charging

66 For exports requiring sea ports, Botswana faces high inland transportation costs to Durban and Walvis Bay. The average cost to send a 40 foot container to Durban from Gaborone is approximately Pula 12,000 (US$2460) to 14,000 (US$2870). This is less than the equivalent cost for Zambia, but equal to Zimbabwe and well above Swaziland (Tagg, 2002). Auto-

[1] Bearing in mind that CIF costs often exclude hidden transport costs, such as demurrage charges.

component exporting firms interviewed for this study reported that the Durban to Gaborone and back route for raw and finished products constitute nearly 60 percent of total transport costs. There are four areas of concern on land transport.

67 First, reviews of the domestic road transport market suggest that there are no major policy restrictions to new entry among the commercially established operators, with the exception of passenger transport, which is restricted to citizens-owned enterprises. However, restrictive cabotage laws (common to all SADC countries) contribute to the high costs of transport in the region – cargo carriers are not allowed to pick up loads at the delivery destination except those destined for their originating country. Government should undertake a review of the impacts of restrictive cabotage laws with a view to initiating a coordinated effort to liberalise these restrictions. Regulatory reform has had a significant impact on prices in other countries – for example, liberalization of the transport market in France reduced transport costs by between 20-40 percent.

68 Second, road charging is a particularly contentious regional issue. Botswana recently revised its road user charges for *foreign-owned* freight vehicles, with an increase of 797 percent in fees for the Tlokweng-Gaborone Section. Typical of transport policy changes in the region, the increase was made without consultation with SACU partners. Government should review these new road charges with a view to revoking them, and should encourage greater consultation among SACU Transport Ministries, possibly by establishing a transport desk within SACU.

69 Third, soda-ash relies on the South African rail parastatal to transport its product within South Africa. The Botswana authorities should investigate the pricing of rail transport by Spoornet, possibly taking up any concerns about monopoly pricing with South African officials through SACU.

70 Fourth, access to many of the main tourism attractions is limited to gravel roads which are mostly only navigable by means of 4-wheel drive vehicles. The undeveloped road system has been applied as a control mechanism to limit tourism. Given the need to spread Botswana's tourism appeal across a wider spectrum of market segments (in particular the self-drive market), the possibility of upgrading some of the gravel access roads to and within the parks should be investigated.

High air transport costs are a major constraint to the development of services exports, re-enforcing the importance of air liberalisation

71 Passenger travel costs are high. Market access to the air transport sector is quite restrictive in comparison with road transport. Air Botswana is Botswana's only designated scheduled airline, with the Botswana Government as sole shareholder. A new bilateral agreement with South Africa will phase-in an open-skies, multi-designated aviation regime over three years from 2004. This should have a major impact on prices. As part of an export diversification strategy, progress in phasing in the agreement should be closely monitored to ensure that it gets implemented within the agreed time frames, if not sooner. Government should also consider setting a new target date for the privatisation of Air Botswana.

Botswana Customs is efficient, although the difference between South Africa's Value Added Tax (VAT) and Botswana's VAT creates a second economic border which should be removed…

72 Customs clearance procedures were recently reviewed and simplified prior to implementation of an UNCTAD project to install the ASYCUDA^{++} computer system in all the main customs clearance points in the country. Imported inputs for export production get customs clearance largely without unnecessary restrictions. However, the difference between South Africa's value added tax (VAT) and Botswana's VAT creates a second economic border. Despite being major trading partners, Botswana's VAT rate is 10 percent, while South Africa's is 14 percent. To mitigate the risk of hijacking or pilferage of goods, South Africa recently made it a requirement that all Botswana freight companies forwarding goods to Durban for export must pay VAT collected before the goods are allowed through South Africa, then have it reimbursed. There have been a number of complaints about the reimbursement procedures and delays.

73 Government should propose a SACU-wide strategy for VAT harmonisation. This should include costings comparing the revenue gains/losses with estimates of the economic losses associated with the increased transaction costs of the VAT differentials. A further resulting restriction is the time allowed for the groupage of products within South Africa – exporters or freight forwarders must prove that goods leave South Africa within 30 days or face a penalty. This rule makes it difficult to containerise goods in South Africa. Botswana should lobby the South African authorities (possibly through SACU) to extend the time allowed for groupage (containerization) of products in South Africa before they are liable for South African VAT.

…while customs-related constraints to regional trade require a push for greater cooperation.

74 Weak and inefficient customs in neighbouring non-SACU countries create significant barriers to regional integration. The textiles sector is a good example – border constraints in Zambia and Zimbabwe will limit the ability of Botswana apparel manufacturers to use cotton from these countries in their production chain – this could be particularly important if the AGOA LDC special exemption is ended in 2007 (see paragraph 57). Further, there are differing customs electronic platforms between South Africa and Botswana, which means that traders with South Africa still need to fill out forms manually to clear goods. In addition, although electronic documentation is now available in the larger customs offices, it must still be accompanied by a paper version as paper documentation is regarded as the only legal declaration.

75 Botswana should push for an effective agreement on trade facilitation in the WTO and should also continue to use existing regional fora, such as SADC, to tackle these obstacles. In the longer-term, Government should champion the creation of a regional SACU customs authority. This would ensure common procedures, reducing transaction costs for shippers. The Department of Customs and Excise is exploring the concept of a 'one-stop border post' with South Africa to reduce border crossing time. As an interim measure, this should be strongly encouraged.

Border constraints are onerous for tourists entering by car, and there is a need to remove multiple tourism taxes and introduce a regional tourist visa.

76 Botswana's central location in Southern Africa and the fact that it borders four countries places it at the centre of the Southern Africa tourism circuit. The absence of a coordinated and tourist-friendly immigration and customs system at the various entry points results in major frustrations and lengthy delays, and could impact negatively on the visitor experience. Botswana, Zimbabwe, South Africa and Zambia all have different immigration and customs requirements and tax regimes, with the result that visitors have to go through a variety of differing procedures in order to move between them. This makes a quick round trip a major exercise with the visitor having to pass through six border control points, often having to wait in long queues, paying a variety of steep entry taxes and wasting valuable time. Government should explore the scope for the introduction of a single, special tourist visa which includes entry tax costs. This could be approved and purchased in advance of the visit at a foreign office of any of the four tourism circuit countries.

Data Limitations

One final point – this study came across a range of data constraints. Resolving these – particularly the lack of recent trade data – will be necessary in developing an export strategy

77 First and foremost, there has been a two-year delay in accessing reliable trade data. Government should review procedures and capacity for collecting trade data at the CSO. The Ministry of Finance and Development Planning must find a way to integrate the software of its two departments that collect (Customs) and analyse (Trade Statistics in CSO). Data should be made available in a usable format on a quarterly basis. One solution could be to contract out this role. Second, there are major weaknesses in the quality of services export and import data (paragraph 1.22). There should be a concerted effort involving the CSO, Bank of Botswana and other relevant departments to reconcile and improve the quality of services exports information. Third, good quality data on productivity would help to identify possible sources of inflationary pressures and the underlying reasons for lack of competitiveness. Fourth, the calculation of a producer price index (PPI) for Botswana would facilitate the calculation of an REER index that is consistent with good international practice. Botswana's REER calculations should, as far as possible, use PPIs for trading partner inflation rather than consumer prices indices.

TABLE 1-1: ACTION PLAN

AREA	**RECOMMENDATION**	**FOLLOW-UP, TIMEFRAME AND PRIORITY**
CHAPTER 2: THE ENABLING ENVIRONMENT I: THE NATIONAL POLICY FRAMEWORK		
National Policy Development – An Overview	1. Government to finalise development of competition law (paragraph 2.6).	MFDP 2005 **HIGH**
	2. Government to review procedures and capacity for collecting trade data at the CSO. The Ministry of Finance and Development Planning must find a way to integrate the software of its two departments that collect (Customs) and analyse (Trade Statistics in CSO). Data should be made available in a usable format on a quarterly basis. One solution could be contract out this role. There should be a concerted effort involving the CSO, Bank of Botswana and other relevant departments to reconcile and improve the quality of services exports information. Further, estimates for productivity and a producer price index would facilitate the calculation of valuable economic data (paragraph 2.10).	MFDP 2005-6 **VERY HIGH**
	3. Government to adopt best-practice principles for Citizen Empowerment Schemes as set out in paragraph 2.7 onwards.	MFDP 2006 **HIGH**
Business Regulation and Foreign Direct Investment	4. Government to convene seminar with key stakeholders to monitor implementation of the recommendations of FIAS 2004 report (paragraph 2.14).	Customs and Excise 2005 **HIGH**

Investment Policy	5.	Government to finalise revisions to the Industrial Development Act with the intention of simplifying the industrial licensing system (paragraph 2.14).	MTI 2005 **HIGH**
	6.	Government to expedite approval of a revised investment code that drops restrictions on smaller-scale FDI (paragraph 2.14).	MTI 2005 **HIGH**
	7.	Government to expedite reforms to land allocation issue (paragraph 2.14).	MFDP 2005 **HIGH**
The Incentives Regime	8.	Government to consider adopting uniform 15 percent tax rate of all business activities. This would make for a much simpler, easier to administer regime which would still place Botswana in a highly competitive position internationally. It would remove the implicit discrimination against the tourism sector, and would eliminate on shore and offshore distinction for tax purposes (see paragraph 3.51). This would of course require an estimation of the budget impacts and an assessment of how this would fit into overall tax policy. Non-mineral income tax, which includes personal income taxes as well, accounts for about fifteen percent of total government revenue, although it is becoming more important as mineral revenues stagnate and SACU revenues decline (paragraph 2.23).	MFDP Next 3 years **MODERATE**
	9.	Consideration should be given to removing the need for a manufacturer to apply to the Ministry of Finance and Development Planning in order to be eligible for the reduced tax rate. The current system, whereby an application is lodged which is then carefully scrutinized, seems to add an unnecessary layer of bureaucracy. Companies could be permitted to take a position as to their eligibility (in line with self-assessment principles), with the Department of Taxes then able to review any claim (paragraph 2.26).	MFDP 2006 **MODERATE**
	10.	The reservation policy should be reformed. As it stands, it is a restriction on trade in certain areas of commercial activity (Table 2-1: Summary of Major Incentive Programmes and paragraph 2.12).	MTI Next 3 years **MODERATE**

	11. Government, in cooperation with SACU and SADC, should establish a clearer role for cooperation to avoid tax competition in the region (paragraph 2.32).	MFDP, BURS Longer-run **MODERATE**
	12. Government to commission cost-benefit review of industrial rebate for raw materials imported for production for sales into the domestic market (paragraph 3.75).	MFDP 2006 **MODERATE**
	13. As part of a broad export diversification strategy, Botswana should reconsider and appraise any broad or specific subsidies (especially interest rate subsidies) for non-tradeable goods activities. For example, CEDA should evaluate project proposals with a view to their net benefit to Botswana, using shadow prices that place a premium on tradeable goods (paragraph 2.19).	MFDP Next 3 years **MODERATE**
	14. Central Statistical Office or another suitable agency or think-tank to conduct a review of ongoing impact monitoring of existing government support programs, tax incentives and reservation policies set out in Table 2-1: Summary of Major Incentive Programmes.	MFDP, CSO Next 2 years **HIGH**
The Labor Market	15. Government could develop a detailed and comprehensive national human resources development strategy, which focuses in particular on the occupational requirements of the key growth sectors in the economy. The development of a labour market information system is essential. Most importantly, this should include a comprehensive reform plan for the vocational education and training sector (paragraph 2.70).	MLHA, MOE, MFDP, BOTA, TEC Next 2 years **HIGH**
	16. The company tax incentive for training requires reviewing and replacing with a more effective incentive for human resource development (paragraph 2.28).	MFDP 2006 **MODERATE**
	17. A resolution of the work permits issue is also required, possibly with permits based on a points system and/or a minimum number of permits awarded automatically for companies (paragraph 2.65). In particular, Government should reassess the cost of obtaining a work permit and visa.	DWP 2005-6 **VERY HIGH**

CHAPTER 3: THE ENABLING ENVIRONMENT II: EXPORT AND SECTOR-SPECIFIC POLICIES		
Sector Policies - Case Studies	***Beef*** 18. Upcoming Government livestock study to fully consider options for BMC privatisation, the removal of export monopoly (in particular to South Africa) and the potential for trade liberalisation to increase exports (paragraph 3.12).	MoA 2005-6 **VERY HIGH**
	Ostriches *19.* Government to eliminate the current ostrich export levy (paragraph 3.24).	MoA 2005-6 **HIGH**
	Tourism 20. The establishment of local tourism associations, which are affiliated to HATAB, in the main tourism centres is recommended. Local businesses of such associations could collaborate with the public sector on issues, such as the cleaning up and beautification of tourism towns, safety, infrastructural issues, community awareness and tourism information provision and reservations (paragraph 3.37). 21. It is crucial that the DWNP be an active and key partner in the formulation and implementation of the national tourism strategy, be closely aligned to the Botswana Tourism Board, and that the Government allocate and manage its budget allocation and investment in the DOT and the DWNP as a holistic package, within a commonly agreed tourism development strategy (paragraph 3.37). 22. Since the tourism success of emerging destinations is reliant upon the active participation and joint visioning of the government and the private sector, a formal partnership agreement should be considered, with both parties committing themselves to the implementation of a jointly agreed national tourism strategy that will guide tourism development over the next decade (paragraph 3.39). 23. A formal partnership agreement between the government and the private sector should be considered.	HATAB Next 3 years **MODERATE** MFDP, DWNP Next 2 years **MODERATE** DWNP, HATAB Next 2 years **MODERATE** DWNP

	This could include funding cooperation and in this regard the establishment of a dedicated Tourism and Conservation Management Fund, to be funded through realistic levies and charges at all tourism points such as parks, mobile tour operators, hospitality establishments, etc. (A tourism bed levy is currently being charged, but it is small and only applicable to accommodation enterprises) (paragraph 3.39). *24.* Further research is needed on the costs and benefits of allowing a longer concession term for tourism leases in wildlife management areas (paragraph 3.41).	Next 2 years **MODERATE** DWNP 2006 **MODERATE**
	Financial Services Exports 25. Government to consider broadening IFSC incentives by making all service exporters eligible for incentives and renaming the IFSC (International Financial Services Centre) the ISC (International Services Centre) (paragraph 3.48). 26. Government to increase efforts to negotiate double taxation agreements 27. Government to expedite a complete overhaul of the regulation of the non-bank financial system, including offshore jurisdiction. In this regard, a unified non-bank financial system regulator approach, similar to Mauritius and South Africa, could be one possible course to follow (paragraph 3.53). *28.* Government to make further efforts to streamline the process of obtaining IFSC tax and regulatory approval and reducing the number of bodies involved (currently the IFSC, the MFDP and the Bank of Botswana), possibly through introducing a one-step approval process (paragraph 3.46).	MFDP 2005-6 **HIGH** MFDP Ongoing MFDP, BOB Next 2 years **HIGH** MFDP, BOB 2005-6 **HIGH**
	The Apparel Sector 29. BEDIA could hold a consultation meeting with the manufacturers who are currently receiving subsidies under FAP to find out what barriers to competitiveness each faces. BEDIA needs to make sure that these barriers, some of which are discussed in this report, are overcome as far as possible (paragraph 3.62). 30. In-company interventions to be developed as part of the national HIV/AIDS strategy (paragraph 3.66). 31. BEDIA could develop a comprehensive response to the low levels of productivity in the textile and	BEDIA 2005 **MODERATE** MoH, Ongoing

	apparel industry. It should commission productivity audits and training needs analysis, identify suitable service providers to address the needs of the industry both nationally and regionally, identify means of financing productivity enhancement and training and develop the market for training service providers to the industry (paragraph 3.65).	BEDIA 2006 **VERY HIGH**
	32. Industrialists in this sector should be encouraged and assisted to form an industrial association to lobby and negotiate for their specific needs. BEDIA could use its offices to facilitate the establishment of an association of Botswana Textile and Apparel Manufacturers that is constituted as an independent, officially registered body[1]. This association would then become the key point of contact with the industry and would represent its interests in discussions with Government and Labour Unions, and could participate in the preparations for trade negotiations (paragraph 3.67).	BEDIA 2006 **MODERATE**
Import Tariff and Exemption Schemes for Exporters	33. Botswana should propose, with SACU, a change in the trade regime to allow anti-dumping tariffs to be eligible for duty exemptions and rebate schemes (Box 4-3).	MTI 2006 **MODERATE**
	34. Government to take follow-up review on whether broadening the definition of inputs that are exempt from customs and VAT would make a significant cost difference to exporters (**Error! Reference source not found.**).	MTI 2005 **MODERATE**
Trade Finance and Export Credit Insurance	35. Conduct a performance audit of the provision of political risk insurance by MTI, including an assessment of need (paragraph 3.85).	MFDP 2006 **MODERATE**
Export Promotion and Private Sector Support Institutions	36. BEDIA and BDC to appraise whether they should continue in the provision of factory shells (paragraph 3.82).	BEDIA-BDC 2005 **MODERATE**
	37. BEDIA to coordinate JITAP implementation to build on work undertaken in this study (paragraph 3.81).	BEDIA 2005 **MODERATE**

Licensing Rules and Standards	38. Undertake a detailed review of all import permits, with a view to removing this requirement for all but a limited number of commodities for security, public health and public morality reasons. Government could review the Control of Goods, Services and Other Charges Act, possibly applying a costs and benefits approach to assess whether a reduced scope for the Act is beneficial. This should include an assessment of the scope of allowing issuing of import permits outside of Gaborone (paragraph 3.94).	MTI 2006 **HIGH**
	39. Government to develop a 'Standards Strategy', which could include an assessment of the scope for greater harmonisation of standards within SACU – in particular whether it would be feasible to introduce a single set of standards across the region, with inspections to be done by single authority with clear guidelines of why inspections are being done (paragraph 3.89).	MTI- Botswana Bureau of Standards 2006 **MODERATE**
	40. At the border, the Department of Customs and Excise conducts verification of import permits and physical examination of goods on behalf the Department of Crop Production and Forestry. These departments should be linked electronically to avoid delays for importers in clearing goods in the event of queries (paragraph 3.94).	Customs, MFDP 2005 **MODERATE**
CHAPTER 4 – TRADE POLICY FOR EXPORT GROWTH		
Market Access Issues	42. Botswana should launch a concerted lobbying effort to improve rules of origin in all preferential trading agreements, starting with a Government-initiated 'rules of origin' strategy paper. In particular, this could advocate for the Economic Partnership Agreement with the EU to allow for single transformation of goods such as found in the AGOA agreement with the United States. In addition, Botswana should lobby for simplified and liberalised SADC rules of origin in the SADC MTR follow-up discussions (quota restrictions should be removed and the derogation should become the general rule for all SADC Member States). Botswana should press within SACU for a concerted and more liberal approach to rules of origin – SACU has been resistant to relaxing rules of origin within SADC, insisting on higher local content to qualify for preferential treatment than other SADC members would like to accept (paragraph 4.30).	MTI Next 2 years **VERY HIGH**
	43. Lobby the EU to improve existing trade preferences for beef products to allow customs duty, quota and special duty free export of a wider range of beef and meat products, without excessive administrative and sanitary restrictions (paragraph 4.17).	MTI, MOA Next 2 years **HIGH**

	44. Prepare detailed estimates of the costs of compliance need to be prepared in order to fully assess the costs and benefits of the current emphasis on sales to the European Union (paragraph 4.37).	MoA 2006 **HIGH**
	45. Botswana should continue to lobby for the AGOA LDC provision to be made permanent in order to provide predictability for potential investors in a particularly unstable market (paragraph 4.21).	MTI Next 2 years **HIGH**
Domestic Protection and the Terms of Trade	46. The Botswana authorities should refrain from using import bans as a tool to sustain local enterprises against foreign competition. This is an arbitrary measure that is borne by the consumer and contributes to the anti-export bias. Government should reconsider the effective import ban on bread and not impose new restrictions on imports of second-hand vehicles (Paragraph 4.59).	MTI, MFDP Ongoing **VERY HIGH**

	47. Botswana should use its influence in the new SACU Secretariat to reenergize the liberalization efforts of SACU. This effort should include: a phased program of tariff reforms that would continue the progress made during the early liberalization period in the 1990s. This should focus on: ❑ reducing SACU's average applied rates (which would be strongly in Botswana's interest). ❑ urging SACU to accelerate its tariff rationalization program to reduce the number of tariff categories from 41 to six, in line with WTO commitments (paragraph 4.52). ❑ lobbying within SACU for the number of anti-dumping initiations to be further reduced (Box 4-3). Government should initiate a short follow-up review of the impact of anti-dumping duties on the cost of Botswana's business inputs. Government to advocate the development of tighter rules on anti-dumping for all WTO members through the WTO Doha Development Agenda. ❑ urging SACU to set up monitoring program of NTBs in similar fashion to a COMESA exercise. ❑ reviewing the impact of liberalizing beef imports with a view to discussing this with SACU neighbours (paragraph 4.63). ❑ developing a regional approach to easing visa restrictions over the longer run, starting with a SACU visa, possibly including SADC members (paragraph 4.45). ❑ Proposing, within the SACU framework, a tightening of SACU members' ability to make use of Article 17 (paragraph 4.46). ❑ proposing SACU-wide limitations on the use of local content requirements that restrict the ability of other SACU members to trade with their SACU neighbours (paragraph 4.47).	MTI Next 5 years **VERY HIGH**

CHAPTER 5 – TRADE FACILITATION		
Customs Procedures, Management and Visa Rules	48. Develop a program for VAT harmonisation by SACU members, including an assessment of costings, comparing the revenue gains/losses with estimates of the economic losses associated with the increased transaction costs of the VAT differentials (paragraph 5.7). Further, Government to propose development of a transit system that covers movement through all SACU Member States.	MFDP 2005-6 **HIGH**
	49. Lobby South African authorities to extend time allowed for groupage (containerization) of products in South Africa before they are liable for South African VAT (paragraph 5.7).	DoT, MTI 2006 **MODERATE**
	50. Explore the concept of a 'one-stop border post' with South Africa to the reduce border crossing time (paragraph 5.11).	Customs 2006 **MODERATE**
	51. Explore desirability of moving towards a regional SACU customs authority (paragraph 5.11).	MTI, MFDP 2005-6 **MODERATE**
	52. Implementation of FIAS (2004) Customs Recommendations (Box 5-1).	MTI, Customs **MODERATE**
	53. Government could set up a 'complaints/ suggestions' post at the main border posts, following a similar initiative by COMESA states (paragraph 5.13)	Customs 2006 **MODERATE**
	54. Customs and Excise to open Tlokweng border gate on a 24 hour basis (at present it is 0600 to 2200) to reduce congestion (paragraph 5.13).	Customs 2005 **MODERATE**

	55. Government to explore the scope for the introduction of a single, special tourist visa that could be approved and purchased in advance of the visit at a foreign office of any of the four tourism circuit countries (Botswana, Namibia, Zambia and Zimbabwe), which will provide access to all four countries (paragraph 5.17).	Immigration Next 2 years **HIGH**
	56. Government to explore scope for reducing or combining multiple taxes that apply when combining Zimbabwe and Botswana in a regional travel package (paragraph 5.18).	MFDP, Customs 2005-6 **HIGH**
	57. Botswana should push for an effective agreement on trade facilitation in the WTO that reflects the varying implementation capacities of developing countries and reduces constraints to trade. It should also continue to use existing regional fora, such as SADC, to tackle these obstacles (paragraph 5.14).	MTI, Foreign Affairs 2005-6 **MODERATE**
	58. Government should propose SACU-wide limitations on the use of local content requirements that restrict the ability of other SACU members to trade with their SACU neighbours (paragraph 4.47).	MTI 2006 **MODERATE**
	59. Government to work with Walvis Bay Corridor Group and other authorities to encourage greater use of Walvis Bay route. This could be achieved by aggressive and continuous marketing needs to be directed at both suppliers and shipping agents; comprehensive measurement of volume and type of freight traffic in the context of a study to investigate the possibility of a coordinated effort by private sector groups to use Walvis Bay. Further, BEDIA could request the Southern African Global Competitiveness Hub to facilitate efficient transportation over the Zambia-Zimbabwe-Botswana transportation corridor in the same way that it has for the Trans-Kalahari and Dar-Lusaka corridors.	MTI- Department of Transport 2005-6 **MODERATE**
	60. Government to undertake a review of government-procured shipping costs to assess whether greater price pressures could be introduced into the market. This could review whether government should import FOB and open transit to tender from national and international importers (paragraph 5.25).	MFDP 2006 **MODERATE**

Land Trans-portation	61. Undertake a review of the impacts of restrictive cabotage laws (common to all SADC countries) with a view to initiating a coordinated effort to liberalise these restrictions (paragraph 5.35).	Department of Transport 2005-6 **HIGH**
	62. Government to review the road charges that started in March, 2004, with a view to revoking them, and fully consulting with other Member States before invoking any such charges in the future (paragraph 5.36).	Department of Transport 2005 **MODERATE**
	63. Government to encourage greater consultation among SACU Transport Ministries, possibly establishing a transport desk within SACU, and encourage intra-SACU dialogue between transport authorities (paragraph 5.36).	MTI, Department of Transport Next 3 years **MODERATE**
	64. Botswana to take up Spoor-net pricing issue within SACU, and to explore whether South African competition laws allow for consideration of rail pricing complaints by BOTASH (paragraph 5.38).	MTI, Department of Transport 2006 **MODERATE**
	65. Government to investigate the possibility of upgrading some of the gravel access roads to and within the parks – for example, from Maun to Moremi, between Chobe and Moremi and within particular zones of the parks. Such upgrades should be accompanied by infrastructure improvements in the selected high density areas of the parks so as to accommodate increased visitor flows in a sustainable manner (paragraph 5.42).	Department of Transport, DWNP Next 3 years **MODERATE**
Air Transport	66. Progress made with the phased agreement towards open skies should be closely monitored, so as to ensure that it gets implemented within the agreed time frames, if not sooner (paragraph 5.45).	MFDP Next 3 years **HIGH**
	67. Government to set a new target date for the privatisation of Air Botswana (paragraph 5.44).	MFDP **HIGH**

The Business Costs of Utilities	68. Revitalise the privatization program – particularly in the area of telecoms and air transport (paragraph 5.50).	MFDP 2005 **HIGH**
	69. To reduce international telecommunications prices, Government should consider instructing BTA to issue an unlimited number of licences for international voice services and lift the ban on providing voice over IP. The monopoly of BTC should not be allowed to continue indefinitely to allow BTC to restructure - Government should set a target date for the privatisation of BTC (paragraph 5.53).	BTA Next 2 years **VERY HIGH**
	70. The Government should encourage the Water Utilities Corporation (WUC) to supply raw water to the industrial estates where textile and apparel manufacturers are located. This would be an enormous incentive to potential investors in weaving, knitting and dyeing plants (paragraph 5.60).	MFDP 2005-6 **MODERATE**

1. DIVERSIFICATION AND EXPORT GROWTH

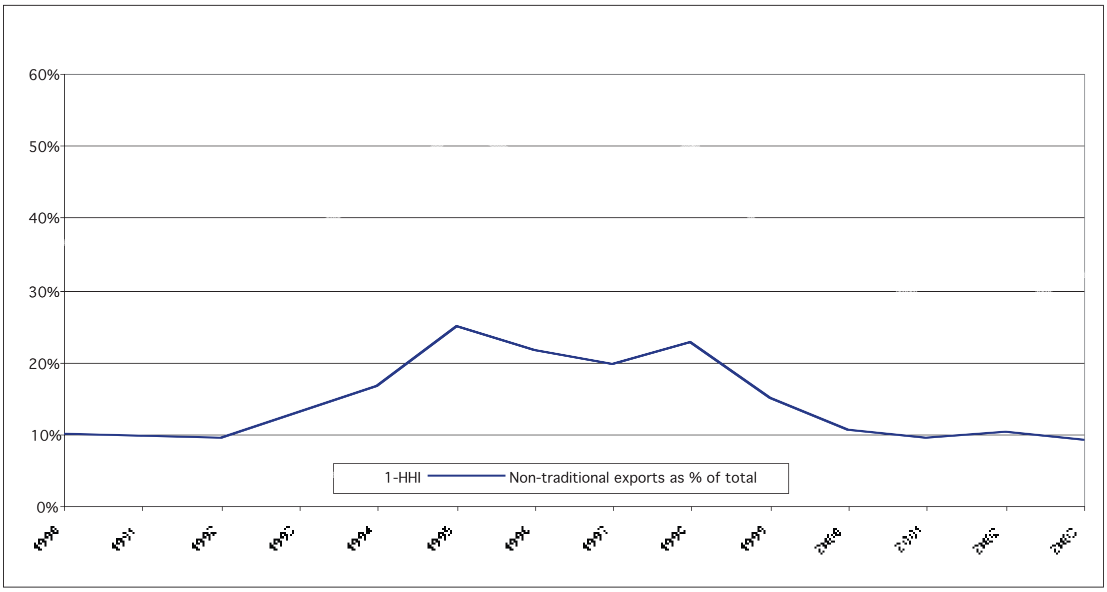
1.1 This chapter addresses three issues. First, in what ways is Botswana's economy not diversified? Second, what are the problems associated with this lack of diversification? Third, what are the key features of export growth in recent years – in particular in the export sectors reviewed as background case studies for this report?

ECONOMIC AND EXPORT CONCENTRATION – SOME INDICATORS

1.2 **The concentration of export activity in diamonds features in most indicators of economic diversity:**

- **share of exports: rough gem diamonds dominate exports, accounting for 83 percent of total merchandise exports in 2003.** The UK accounts for 85 percent of all exports because diamond exports are routed through London before being sold on the world market. Beef exports – Botswana's other main export – are not diversified. All exports of chilled and frozen beef are to the EU market, largely because Botswana benefits from EU preferences on beef. Botswana scores 0.63 in the Herfindahl-Hirschmann index for diversification of exports (where 1 represents no diversification).

Figure 1-1: Measures of Export Diversification, 1990-2003



Source: Bank of Botswana

- **tax base:** mineral taxes and royalties are projected to account for approximately 46 percent of total government revenues in budget year 2003/04. This is lower than the 2001/02 budget year figure of 55 percent because of the increase in customs revenues resulting from new revenue-sharing arrangements in SACU and the introduction of VAT in July 2002.

- **foreign investment:** 75 percent of the stock of FDI in 1999 was concentrated in the mining sector (UNCTAD, 2003). The bulk of this investment was in Debswana, a joint venture between the Government and De Beers.

- **GDP:** Mining accounted for 35 percent of total GDP in 2002/03. It has been relatively constant at this level over the last ten years, with the exception of a peak between 1996-98 (39 percent) and a trough in 1998/99 (31 percent). In terms of relative shares of GDP, mining has replaced agriculture as the dominant activity, although the share of other sectors has more recently kept pace with mining growth and hence has remained roughly constant over the last decade. Mining accounted for about one-third of total GDP growth between 1974/75 and 1999/00. However, GDP figures may understate the contribution of mining to economic activity. Mining revenues contribute to government finances, and public sector consumption equals 37 percent of GDP. General government accounts for 16 percent of GDP, the second largest component of economic activity after mining.

- **employment:** diamond-mining represents a relatively small share of employment because of its capital-intensive production methods. Mining and quarrying accounted for 3.4 percent of total formal employment in 1999 (the latest available figures)[1]. However, high diamond revenues have allowed a rapid expansion in direct and indirect government employment. The share of wage employment accounted for by central and local government was 27.4 percent in 2001 according to Population Census employment data. Public sector wages were 11.5 percent of GDP in 1999 compared to an average of 4.5 percent for OECD countries (UNCTAD, 2003). Between 1990 and 2000 direct employment by Government accounted for 74 percent of total formal sector employment growth (Bank of Botswana, 2000), although this figure should be treated with caution since there was a break in the labour statistics in 1996. A significant share of 'private' employment is also dependent on public expenditure through the public investment program (government accounted for 60 percent of construction investment in 1994/95, for example), government procurement and the government wage payments.

COSTS AND BENEFITS TO CONCENTRATION

1.3 **Diamond production has conferred enormous benefits to Botswana.** The authorities have rightly adopted a policy of encouraging investment, production and returns from diamonds. The Diamond windfall relaxed three traditional constraints to economic growth: namely foreign exchange, fiscal revenues and domestic savings. This has enabled the rapid development of human, physical and financial capital for which Botswana is well-known.

1.4 **However, the old adage that "there is no rose without thorns" applies.** There are a number of concerns[2] about the current domination of diamonds in the export profile, as set out below.

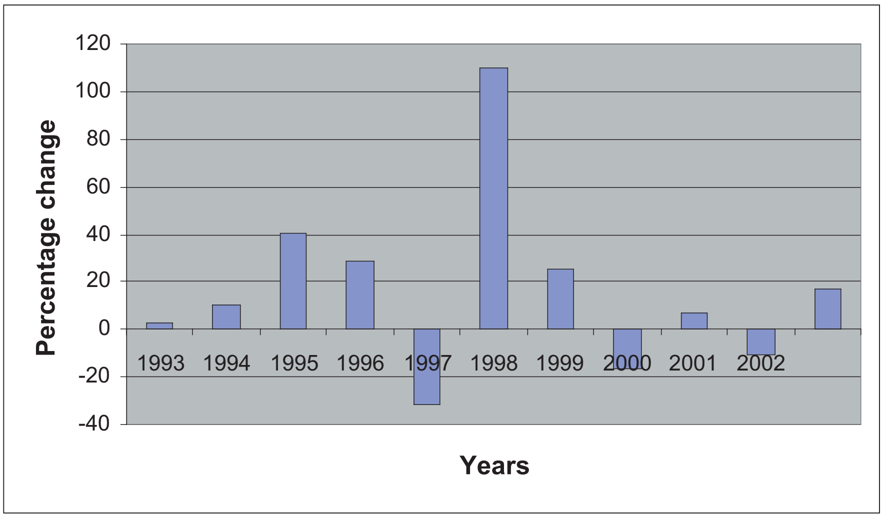
1.5 **First, there are high price and demand uncertainties in the diamond market.** Reliable estimates for the long-term trend in diamond prices are both conflicting and hard to find. This is not because of any particular lack of transparency, but because of difficulties in forecasting demand, the impacts of technological change and regulatory change. De Beers has in the past acted as a "buyer of last resort", and ensured price stability by imposing quotas on its suppliers of rough diamonds in 2001. The world recession in the early 1980s led to a fall in demand for diamonds, which led De Beers to impose strict export quotas – Botswana sold no diamonds for several months. Since then the diamond market has been

[1] This figure is likely to be overstated because it does not take into account informal employment.
[2] In a recent review of Botswana, Moody's (2004) identifies two key risks to Botswana's high credit rating: HIV and the lack of economic diversification.

buoyant, with prices rising around 4 percent per annum (EIU, 2004). Rough diamond prices are near their historical high of the late 1990s. IMF (2004) simulate the impacts of a 5 percent permanent fall in diamond prices on Botswana's economy. This would include a halving of the external current account surplus within one year, then a deficit starting in 2007, and the government's budget would shift to deficits close to 3 percent of GDP by 2008/9.

1.6 Rough diamond sales are exported to London for sorting and processing, although demand for diamonds is spread across a number of major markets. The US, however, accounts for over 50 percent of world diamond jewelery sales, hence Botswana's exports have a high indirect exposure to US market demand.

Figure 1-2: Annual Change in Government Mineral Revenues, 1993/4 to 2002/3



Source: Bank of Botswana

1.7 'Diamond price optimists' predict a rise in prices of 40 percent by 2012, by which time they project a $4bn excess demand. Meeting this would require 50 percent more production – analysts do not expect any major new supply coming on stream in the next ten years apart from the large Diavik mine in Canada producing approximately 550 million USD annual output. In contrast, 'price pessimists' point primarily to the impact of synthetic ("cultured") diamonds, which have recently been introduced to the market. There are fears that this could have the same impact that artificial pearls had on the pearl market. One well-known industry insider argues that polished diamond prices will fall to the lower level of synthetic diamonds in future. Other downside risks include a large overhang of rough and polished stocks amounting to approximately 1 billion USD above normal stocks, possible distress selling because of high debt held by cutting centres facing potential liquidity problems, and a worldwide series of anti-trust actions against De Beers. Indeed, the new business model introduces competition into the business and emphasises the role of marketing instead of supply-management to maintain prices. De Beers' control of rough stones has fallen from approximately 80 percent of the market to around 55 percent in 2004.

1.8 **Second, there are questions over whether Botswana's diamond output growth can be sustained.** Open caste mining is projected to last about another 25 years at current extraction rates. Underground mining, which is much more expensive, may extend the duration of diamond exports to 40 years. The 'compounding issue' whereby new growth is based on a higher GDP than in the past makes it unlikely that current diamond growth rates can themselves sustain continued growth at current levels. However, Botswana could sustain current rates of growth in production if substantial new diamond deposits are identified and mined – this is possible given the amount of prospecting taking place and the fact that numerous diamondiferous kimberlites have already been identified.

1.9 **Third, the government budget relies heavily on unstable diamond revenues denominated in US dollars.** Mineral taxes and royalties (mainly diamonds) accounted for approximately 52 percent of total government revenues and grants in the 2003/04 tax year. While Botswana has pursued a prudent fiscal policy, running budget surpluses most years, the budget faces serious pressures in the long run. Customs revenues may fall in the longer run because of further tariff liberalization initiatives. Demands on the recurrent budget are high and surpass the capital budget. After facing large budget surpluses for most of the 1980s and 90s, Botswana recorded budget deficits for three of the last five years. Combating HIV/AIDS will have long-term implications for the government budget, with treatment costs projected to rise to over 10 percent of GDP by 2010 and possible implications for public sector pension commitments. Large sections of the rural community are dependent on welfare payments. In addition, because of fluctuations in diamond demand and exchange rates, mineral revenues are unstable – the average annual change between 1993-2003 was 28 percent, with revenues falling in three of these ten years.

1.10 This brings a high cross-exchange rate risk. As discussed in Chapter 2, Botswana's principal export revenues and earnings on foreign exchange reserves are denominated in dollars and based heavily on US demand for diamonds. However, its imports are not denominated in dollars, hence currency fluctuations such as the current fall in the value of the dollar and increase in the value of the rand reduce national income and Government budget revenues.

1.11 **Fourth, diamond production creates few direct jobs, skills or technology transfer**. Diamond-mining is capital-intensive and hence represents a relatively small share of employment. Mining and quarrying has one of the smallest shares of formal employment in Botswana, having declined from about 5 percent in the early 1990s to about 3 percent in 2001. A Bank of Botswana report (Bank of Botswana, 2000) claims that diamond production could become even more capital-intensive, referring to new investments at the Orapa and Jwaneng diamond mines to increase automation.

1.12 There are mixed views on the extent of upstream or downstream linkages associated with the diamond mining industry in Botswana. Most supplies and equipment for the mining industry are imported – 60 percent of purchases of goods and services for the diamond industry between 1980 and 1995 were imported (Gaolathe, 1997). Downstream linkages are also fairly weak. With strong competition in cutting and polishing from countries such as India and Armenia, Botswana has struggled to develop competitive industries to add value to its rough diamonds. One area of success has been the setting up of the Botswana Diamond Valuing Company (BDVC) in 1974 to undertake the sorting and valuing of diamonds that had previously been done in London for a fee. Government is currently commissioning a study to assess the potential for more downstream value-adding in the diamond sector. Further, there has been some direct skills transfer from diamond industry to the rest of the economy. For example, Debswana lost nearly 25 percent of all skilled, technical and professional manpower it trained between 1969 and 1996 (Gaolathe, 1997) and approximately 90 percent of Debswana's workforce is Batswana.

1.13 **Fifth, as a small, open and net food-importing country, Botswana relies heavily on imports to meet its demand for food and manufactured goods.** As part of a prudent macroeconomic policy the Government has built up foreign reserves totalling US$5.474 billion (2002). Reserves equal about two-thirds of GDP and more than half the government's net annual expenditure and lending. The main motivation behind the high reserve policy has been to manage the risk of the budget and imports relying so heavily on diamond revenues. However, reserves can only provide a temporary buffer against a permanent economy-wide trade shock – reserves are equivalent to about two years of diamond exports at current rates. Botswana has successfully reduced imports as a share of GDP from about 62 percent in 1980-85 to 35 percent in 2000-04. However, food-crop production (mainly maize, sorghum, millet and beans) still provides for roughly one-third of consumption.

1.14 **Sixth, the growth of the diamond sector has had an impact on the incentives to develop exports in the non-diamond sectors.** See Box 1-1 below.

Box 1-1: Has Botswana caught 'late-onset' Dutch Disease?

- "Dutch Disease" refers to the process whereby economies with a booming sector (e.g. minerals) experience an appreciation of the real exchange rate that causes a contraction of the tradeables (e.g. manufacturing) sector. The basic mechanism is that the spending of the additional income generated by the booming sector (perhaps through government spending based on taxes levied on the booming sector) increases the demand for domestic resources. The non-tradeables sector, which is not subject to international competition, raises prices to maintain profitability. The tradeables sector, however, cannot raise prices, as these are set in international markets, and profitability declines in the face of higher factor costs, leading to the movement of resources from the tradeables sector to the non-tradeables sector. The real exchange rate (measured as the ratio of non-tradeables to tradeables prices) appreciates, as will the nominal exchange rate, if the exchange rate is floating. The tradeables sector, which becomes less competitive, contracts. This is the basis for Dutch disease-induced deindustrialisation (or de-agriculturalisation, if the tradeables sector comprises predominantly agricultural products).
- It is not necessarily appropriate to term this process a "disease", as it simply describes the adjustment process to a higher level of real income as a result of the boom. However, if the boom is expected to be temporary, and if the economy is not expected to adjust smoothly to the new equilibrium, some "protection" of the tradeables sector from the Dutch Disease is often considered. While Corden (1984) notes that the best form of protection is a direct subsidy of the tradeables sector (financed by taxes levied on the booming sector); an alternative is to use "exchange rate protection" whereby the maintenance of a fixed exchange rate prevents the nominal exchange rate from appreciating, thus inhibiting real appreciation. The outcomes of such exchange rate protection include the accumulation of foreign exchange reserves; keeping consumption below the levels that would otherwise result from the higher (boom-induced) real income; and a forced balance of trade surplus. Exchange rate protection needs to be accompanied by sterilisation of the monetary impact of reserve accumulation, whether through open market operations or budget surpluses, and the resulting suppression of aggregate demand growth helps to contain the upward pressure on the relative price of non-tradeables.
- Botswana attempted to use such exchange rate protection in an attempt to deflect Dutch Disease-induced real appreciation. Whether the policy has been successful is difficult to ascertain. The main period of rapid structural change in the economy occurred as the minerals sector grew rapidly during the late 1970s and the 1980s. [1] A long-term REER series (comparing domestic and foreign prices) covering that period provides no evidence of real appreciation – indeed significant real depreciation seems to have occurred during the 1980s. Nevertheless, the process of structural change in the economy is highly consistent with Dutch Disease predictions, with the relatively slow growth of the tradeables sectors (agriculture and manufacturing) relative to the non-tradeables (mainly services) sectors.

- With regard to the movement of prices by tradeability, it is unlikely that non-tradeables prices would have risen relative to tradeables prices during the 1980s given the REER trends noted above.[1] However, a process of rising relative non-tradeables prices has been apparent since the late 1990s, which has also shown up in the appreciating REER.
- To ascribe recent real exchange rate appreciation to the Dutch Disease would require some explanation of a long-delayed impact of the minerals boom, as well as discussion of how the Dutch Disease mechanism works in the absence of nominal appreciation. One possible mechanism is through the costs of skilled labour, as follows. Rising government expenditure, financed substantially through taxes on the minerals sector, has generated demand for skilled labour (compounded by demand from the booming sector itself, although this remains relatively small in employment terms). As the supply of skilled labour is less than perfectly elastic (a result, in part, of restrictions on immigration of skilled labour), its cost rises for all sectors of the economy. The non-tradeables sector raises prices to maintain profitability, while the tradeables sector cannot do so due to international competition, and hence its profitability declines. Returns to other factors (unskilled labour and capital) are unaffected by this spending effect, as the supply of unskilled labour is highly elastic, due to unemployment, as is the supply of capital, since domestic savings exceed investment. The result of this process would be real appreciation, as the price of non-tradeables rises relative to the price of tradeables. The appreciation of the real effective exchange rate (REER) in Botswana has been partly driven by higher inflation for non-tradeable goods and services, which grew on average by 9 percent a year compared to 7 percent a year for tradeable products between 1997 and 2004.
- The reason for the long delay in this process after the initial minerals boom may be a result of the relatively strict wages policy that was maintained until the early 1990s, whereby government deliberately aimed to restrain growth in skilled wages in both the public and private sectors. Following the removal of controls on private sector wages and the relaxation of controls on wages in the parastatal sector, there is some evidence that wages for skilled workers have risen more rapidly than wages of unskilled workers, which could explain the rise in non-tradeables prices and the slow growth of the manufacturing sector. Government salary increases have been large and not connected to productivity and efficiency increases – the average nominal increase in 2004 was approximately 15 percent with inflation averaging 7 percent. Between 1990 and 2000 direct employment by Government accounted for 74 percent of total formal sector employment growth (Bank of Botswana, 2000).
- Corden (1984, p.359), presents an interesting alternative interpretation of the Dutch Disease: "it might be argued that the true Dutch Disease in the Netherlands was not the adverse effects on manufacturing of real appreciation but rather the use of Booming Sector revenues for social service levels which are not sustainable, but which it has become politically difficult to reduce". It is beyond the scope of this study to assess how far this applies to Botswana. Government expenditure growth has declined from averaging 20 percent per year to approximately 6 percent per year in 2004. Expenditure has grown not just in social services – Government has been the main driver in procuring construction too – at its peak, government accounted for 60 percent of construction investment in 1994/95.

EXPORT PERFORMANCE OVERVIEW

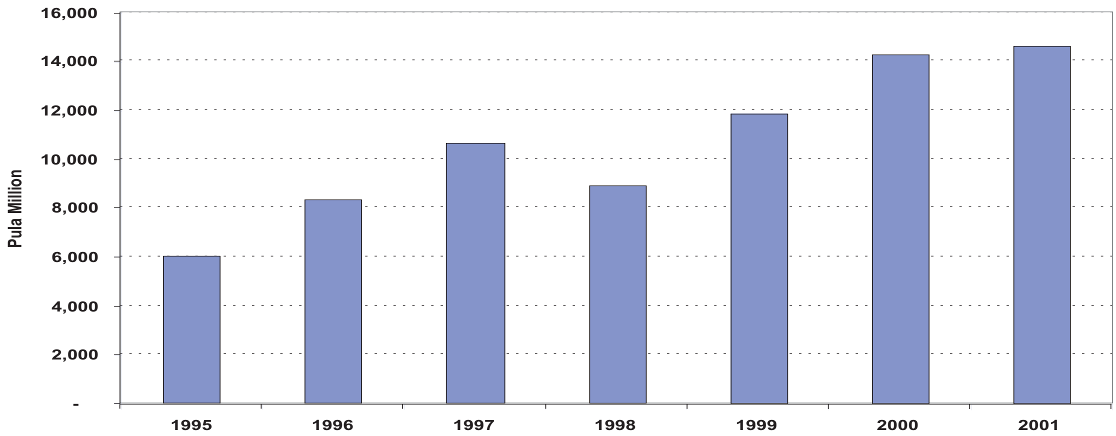
Overall Trends

1.15 **Botswana's growth has been fuelled by exports.** External trade has fuelled an economic transformation over the last 30 years. Exports grew by an average of 21 percent per annum since 1980. Botswana doubled its share of world exports from 0.009 percent in 1990 to 0.017 percent by 2000, a growth significantly outperforming other countries in the region and internationally. Only four other countries in Eastern and Southern Africa (Lesotho, Madagascar, South Africa, and Sudan) managed to increase their shares in world exports in the 1990s.

1.16 **A rapidly growing export sector in diamonds fuelled this increasing integration into global markets.** Since the mid-1980s to the late 1990s, the share of diamonds in total exports averaged 75 percent a year. In recent years, the share has increased to 84 percent. While the value of merchandise exports has increased rapidly, its composition has therefore remained largely stable. This is in common with other countries in Eastern and Southern

Africa, where export compositions changed only marginally since 1990[3].

Figure 3.2: Botswana Exports (Pula Millions)



Source: CSO

Table 1-1: Composition of Exports (US$'000)

	1997	1998	1999	2000	2001
Live Animals and Animal Products	64,185	71,568	50,397	51,769	62,556
Vegetable products	3,081	4,488	3,868	4,565	3,900
Animal and Vegetable Fats and Oils	647	843	958	2,108	575
Foodstuffs, Beverages & Tobacco	17,845	21,144	20,442	19,031	11,290
Mineral Products	7,134	8,676	12,010	9,674	9,264
Chemical Products	38,886	28,881	29,128	25,084	28,997
Articial Resins, Plastics etc	6,010	6,645	7,006	8,191	5,888
Raw Hides & Skins etc	9,563	8,887	6,401	8,822	10,457
Wood Products	801	385	408	472	321
Paper materials etc	6,647	7,204	7,191	9,622	7,892
Textiles & apparel	68,019	71,518	53,724	47,396	32,295
Footwear etc	4,996	5,399	4,309	2,771	1,769
Stone, Cement, Glass etc	2,383	1,564	1,255	650	694
Precious Stones, Metals, etc	2,187,400	1,493,718	2,190,516	2,298,379	2,089,158
Base Metals	144,425	117,014	133,815	172,336	106,742
Machinery & Appliances	21,741	22,610	44,035	40,169	18,500
Transport Machinery & Equipment	326,833	229,114	146,489	58,587	53,101
Optical Instruments etc	882	672	1,435	1,016	852
Arms & Ammunition	9	27	1,469	57	67

Source: BIDPA

1.17 **The UK accounts for the majority of Botswana's merchandise exports (86 percent), although this is largely due to an internal arrangement in the De Beers' Central Selling Organisation.** Rough diamond exports are sent to London for sorting and processing. Table 1-2 shows the latest direction of trade data. This data understates the role of the US as a market for Botswana's exports, since a large share of cut diamonds are

[3] For Eastern and Southern African countries as a bloc, the share of primary goods in total exports fell in the 1990s, but primary goods still constituted almost three-quarters of total exports.

ultimately sold in the US. The diamond marketing arrangements of De Beers further distort direction of trade statistics because diamond exports were switched from Switzerland to the UK in 2000.

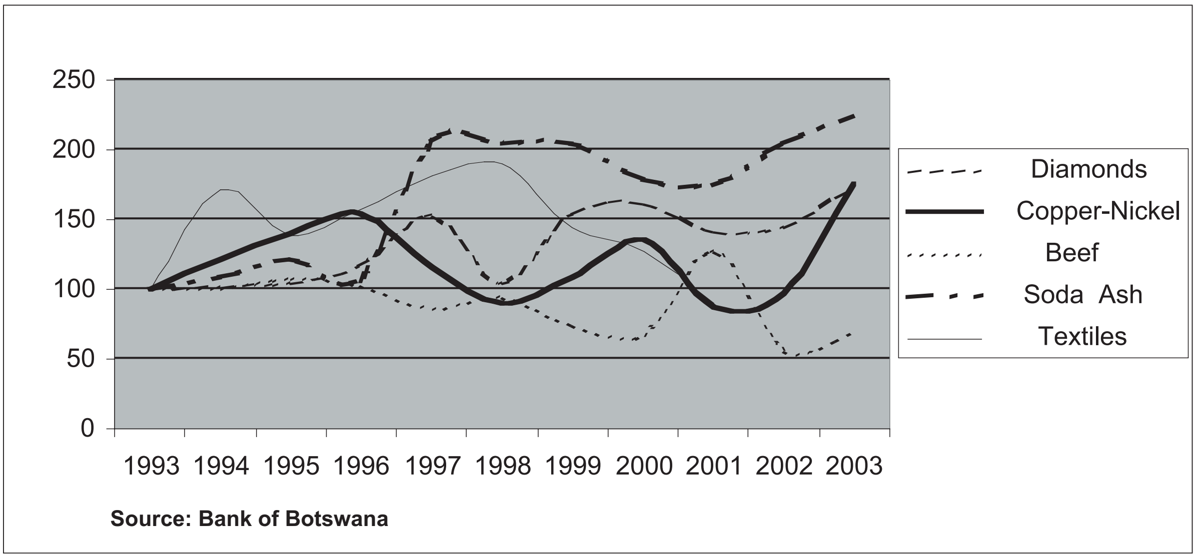
Table 1-2: Direction of Exports (as a percentage of total exports)

	1995	1998	2000	2001
RSA	21.13	16.54	6.50	6.42
UK	37.26	55.59	69.92	85.83
Switzerland	30.75	16.33	13.33	0.01
ROW	10.86	11.54	10.24	7.75

Source: CSO

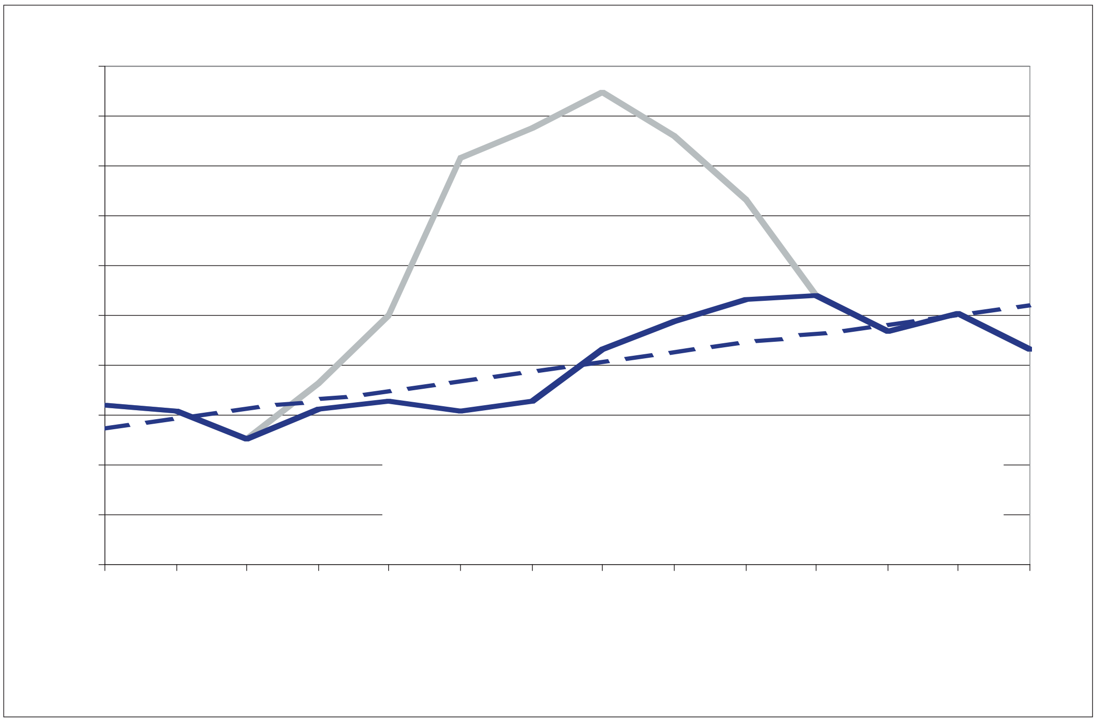
1.18 **Botswana's non-diamond exports had, until 1994, been concentrated around five major commodities: copper-nickel matte, soda ash, meat, hides and skins, and textiles.** Copper-nickel matte, and meat and meat products traditionally dominated the non-diamond export basket until the collapse of copper-nickel matte market that started in 1990. The emergence of motor vehicle exports in 1993 led to a significant shift in export composition. Within a year vehicle exports became the single largest non-diamond export commodity. The expansion of exports to South Africa in the period 1995-97 and the recent slowdown are mainly attributed to Hyundai motor vehicle exports. The value of vehicle exports to South Africa increased to P815.9 million in 1997. With the collapse of the Botswana Motor Company (which was assembling Hyundai vehicles), vehicle exports declined rapidly.

Figure 1-3: Selected Merchandise Trade Indices, 1993=100



1.19 **An alternative measure of diversification looks at the growth of "non-traditional exports"**, which have been defined as merchandise exports excluding diamonds, beef, copper-nickel and soda ash. Non-traditional exports accounted for around 10 percent of total merchandise exports in the early 1990s, and a similar proportion in 2000-2003. The non-traditional export share however rose to over 20 percent in the mid-1990s, largely as a result of the establishment of the Hyundai vehicle assembly plant, but the rise in non-traditional exports proved unsustainable once the plant closed in 2000. A broader measure of diversification (1 – the Hirschmann-Herfindahl index, or HHI), also shown in Chart 5, similarly shows no sustained progress; in fact, apart from the Hyundai-related developments in the mid-1990s, merchandise exports have become less diversified during the period under review.

Figure 1-4: Real Non-Traditional Exports, 1990-2003



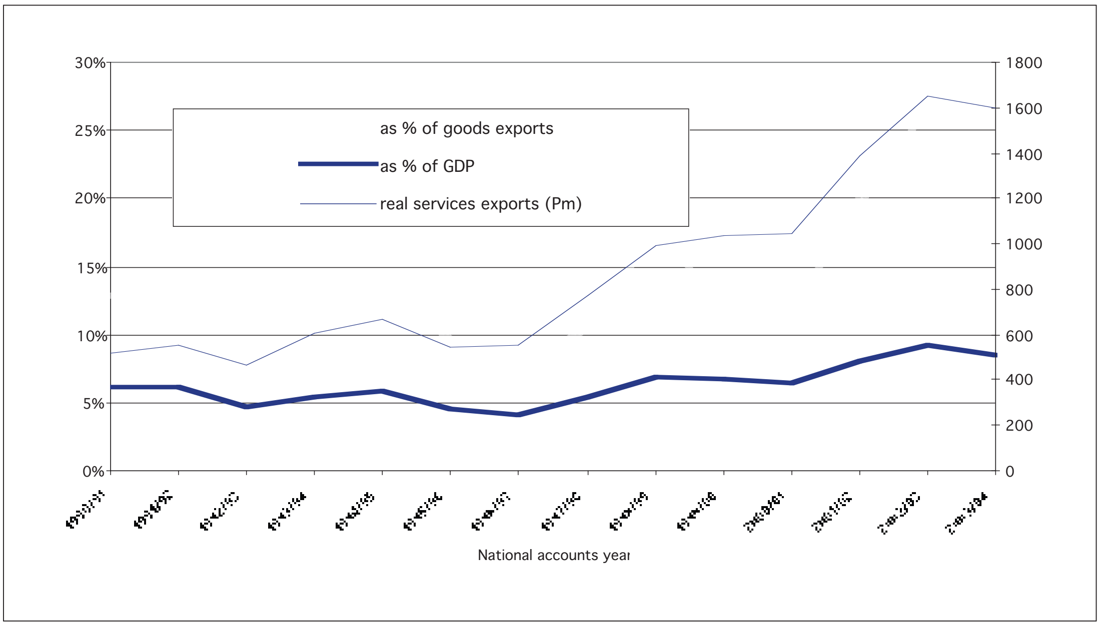
Source: Bank of Botswana

1.20 **The geographical composition of Botswana's *non-diamond* export market has remained concentrated since the 1980s.** The major export destinations have remained South Africa, Zimbabwe and Norway. In the period 1995-99, the three countries accounted for 90.5 percent of the market of non-diamond exports. The only change in the direction of non-diamond exports has been with respect to Zimbabwe and South Africa. In the period 1992-94 South Africa became the main non-diamond export destination taking 44 percent of the exports exceeding Zimbabwe whose share dropped to 16 percent (from 31 percent in the period 1989-91). During the period 1995-97 the share of non-diamond exports to South Africa increased to 61 percent while Zimbabwe's share dropped even further to 12 percent. However, in recent years the share of exports to South Africa has been declining, dropping to 55.5 percent in 1998 and 50.5 percent in 1999. Zimbabwe's share has stagnated at around 12 percent. In the period 1995-97 exports to Norway declined following the collapse of the copper-nickel matte market. The share dropped from 26.5 percent in the period 1989-91 to 13 percent in the period 1995-97. However, with the revival of the copper-nickel matte market and the expansion of beef exports, the share of exports to Norway has been increasing. The share reached 16 percent in 1999.

Services exports

1.21 **One positive aspect of export diversification relates to trade in services.** As Figure 1-5 shows, services exports have been rising steadily in real terms, with an average annual growth rate of around 10 percent in real terms between 1990 and 2003 compared to 3 percent a year for goods exports. Tourism, financial and other business services have played a key role on this growth.

Figure 1-5: Services Exports, 1990/91 – 2002/3



Source: Bank of Botswana

1.22 **However, the data are not strong enough to pinpoint services export trends with any great accuracy.** The services export account covers a broad range of services including insurance, transportation and other professional services. The recent change in net services imports is explained in part by a reduction in services transport costs associated with a decline in the growth rate of imports over 2003. However, these statistics are only approximate estimates, relying heavily on information provided by banks in foreign exchange transfer forms. There are discrepancies between data provided by the Central Statistics Office and the Bank of Botswana, although these are much larger for services imports data than for services exports.[4] The data are also not representative of all the sectors, e.g. education services are not included. Certain data also present anomalies – for example almost half of the services exports in 2002 were generated by the export of government services, which is highly unlikely. Trade in services appears as one, relatively small, line item in the national accounts with no breakdown in any published version.

Regional Trade

1.23 **Trade ties with South Africa have played a central role in the development of Botswana.** South Africa is the primary market for Botswana's non-traditional exports, constituting 75 percent of non-traditional exports. However, Botswana's share of exports to South Africa has decreased from 21 percent in 1995 to 6 percent in 2001. Exports to South Africa increased temporarily at the end of the 1990s because of the Hyundai motor vehicle plant sales to South Africa. In the period 1995-97, vehicle sales accounted for almost 54 percent of total exports to South Africa. Botswana accounts for only approximately between 1 and 5 percent of South Africa's imports in recent years.

1.24 **The BLNS countries remain an important market for South Africa especially after the removal of sanctions and opening up of South African trade that took place in the 1990s.** South Africa continues to dominate regional trade - accounting for nearly 75 percent of total intra-SADC exports in 2003. Eighty percent of Botswana's imports came from

[4] The Bank of Botswana plans to work with the IMF in 2005 to move away from reliance on foreign exchange forms and to use surveys to obtain services trade data.

South Africa in 2001. The trade deficit with South Africa has increased in recent years – rising from P2.6 billion in 1995 to P7.2 billion in 2001. This was almost entirely driven by a rapid increase in imports plus decrease in exports as stated above. The trade imbalance between South Africa and regional neighbours was at 9:1 in 2001 and is unlikely to change dramatically in the near future.

Table 1-3*:* Botswana's Trade with the Region
(percent Share of Total)

Year	**SACU Region**	**Zimbabwe**	**Other Africa**
1998	17.2	2.9	1.3
1999	10.4	2.4	1.1
2000	6.7	3.9	0.9
2001	6.5	2.6	0.8
2002	na	na	na
2003	na	na	na

Source: *Bank of Botswana Annual Reports, 1999-2003*

1.25 **Exports to Zimbabwe have declined for two main reasons:** the appreciation of the Botswana pula against the Zimbabwe dollar; and the unfavourable trading climate for Botswana exporters due to the imposition of non-tariff barriers by Zimbabwe. These NTBs (see paragraph 4.30) disqualified most of Botswana's exports from the trade agreement signed between the two countries. Further, the significant decline in manufacturing and agricultural output by Zimbabwe has led to lower purchasing power and demand for inputs from regional neighbours, with South Africa often replacing Zimbabwean products in regional markets. Zimbabwe's exports to the SADC region have fallen by about 70 percent in recent years. Beyond South Africa and Zimbabwe, the rest of Africa accounted for only 0.8 percent of Botswana's Trade in 2001.

Comparative Performance Data and Analysis

1.26 **Has Botswana been focusing on products where demand is dynamic (growing) or stagnating?** Dynamic products are defined as those products that grow at a rate higher than the growth of world exports, which was 7 percent in the 1990-2000 period. Yagci and Aldaz-Carroll (2004) calculate that of 225 products at the three-digit level, 59 are dynamic products for the 1990-2000 period.

1.27 **Revealed comparative advantage (RCA)[5] calculations suggest a high advantage in Botswana's current trading profile of minerals and beef.** The highest items include copper mattes; cement copper (precipitated copper); nickel matte, nickel oxide sinters; diamonds, not mounted or set; salt; and fresh or chilled meat of bovine animals. With the exception of diamonds, the items have not fully realised their export potential. Botswana has a revealed comparative advantage in 28 items (Table 1-4 below). Items benefiting from preferential trade access are highlighted. The likely erosion of preferences in those markets (see paragraph 4.15) will lead to lower RCA indices.

Table 1-4: Botswana's Revealed Comparative Advantage

Product code	Description	RCA
7401	Copper mattes; cement copper (precipitated copper)	378.1
7501	Nickel matte, nickel oxide sinters	226.9

[5] The RCA of a country in a product is measured as the ratio of that product's share in the country's exports to the share in world exports. If the RCA is higher than one, the country is said to have revealed comparative advantage in that product relative to the world.

Product code	Description	RCA
7102	Diamonds, not mounted or set	104.9
2501	Salt	27.1
0201	**Meat of bovine animals, fresh or chilled**	**10.4**
1522	Degras and residues	9.3
6811	Articles of asbestos-cement, of cellulose fibre-cement	9.1
0507	Ivory, whalebone etc, unworked	6.1
7215	Bars & rods of iron or non-alloy steel nes	4.5
0202	**Meat of bovine animals, frozen**	**4.3**
2834	Nitrites; nitrates	4.0
2836	Carbonate;peroxocarbonate, commercial ammonium carbonate	4.0
6305	Sacks and bags of a kind used for the packing of goods	3.9
1103	Cereal grouts, meal and pellets	3.6
1603	**Extracts & juices of meat, fish, crustaceans & molluscs**	**3.5**
6503	**Felt hats and other felt headgear**	**3.4**
9601	Worked ivory & art of ivory; animal carving material (o/t ivory)	3.2
4823	Other paper, paperboard, cellulose wadding cut to size & adhesive paper, filter paper	2.6
8544	Insulated wire/cable	2.3
7228	Bars & rods, other alloy steel; hollow drill bars, etc.	2.2
6102	**Women's overcoat, cape, etc, knitted/crochetd, o/t of hd 61.04**	**2.2**
1602	**Prepared or preserved meat, meat offal or blood,**	**1.2**
1502	**Bovine, sheep & goat fats**	**1.2**
1512	Safflower, sunflower/cotton-seed oil & fractions	1.2
3002	Human & animal blood; antisera, vaccines, toxins, micro-organism cultures	1.2
1902	Pasta & couscous	1.1
2824	Lead oxides; red lead and orange lead	1.1
3210	Paints & varnishes	1.0

Source: BIDPA

The Role of FDI in Exports

1.28 **While the stock of FDI relative to GDP (approximately 14 percent in 2003) is lower than the SADC average, foreign-owned companies account for more than half of Botswana's exports.** Table 1-5 describes the significant role of FDI in the manufacturing sector. In the minerals sector, Debswana, a joint De Beers – Government of Botswana enterprise, dominates production. The other major mineral exports, copper-nickel and soda ash, are also from joint Government-private sector ventures.

Table 1-5: Share of Foreign Companies in Manufacturing – 2000

Sectors	Domestic Sales (percent)	Exports (percent)
Meat and meat products	5-10	5-10
Dairy products	70-85	0
Bakeries	60-65	0
Beverages	90-95	0
Textiles	90-95	90-95
Clothing and other apparels	55-70	90-95
Leather	70-80	90-95
Wood	70-80	90-95
Paper	80-90	90-95
Chemical	50-65	50-60
Rubber plastic	80-90	90-95
Metal	70-80	80-90
Others	60-70	70-80

Source UNIDO (2002).

1.29 **Investors in the textile and apparel industry from South East Asia are driving much of the growth in textiles and apparel in Sub Saharan Africa.** In 2001 in Lesotho, South East Asian investors owned 85 percent of the apparel factories employing 97 percent of the workforce.[6] A significant Botswana success story in this industry is a partnership between a Motswana and a Taiwanese investor. They have developed a company that is growing, making significant penetration of a wide range of markets, and is proving to be a powerful combination with the Motswana-bringing local knowledge and influence to the partnership, while the Taiwanese supplies the international trading connections, including access to the markets and raw material sourcing.

1.30 **In the automotive sector**, entry into the sector has been facilitated by foreign investment. Of the five firms surveyed for this study, two are fully foreign owned companies, whereas the other three have local equity participation; one majority foreign owned and the other two having equal equity shares. **In the tourism sector foreign investment also plays a critical role.** While citizen-owned licenses have increased from 28 percent in 1998 to 40 percent of all licenses issued in 2003, joint ventures and non-citizen licenses represented 27 and 33 percent of all licenses respectively in 2003.

1.31 **South Africa is the major single source country for FDI – it accounted for 49 percent of the stock of Botswana's FDI in 1999.** Most of this was in the diamond sector, but also included the construction, property, finance and wholesale and retail sectors.

2. THE ENABLING ENVIRONMENT I: THE NATIONAL POLICY FRAMEWORK

2.1 This chapter reviews economy-wide issues that have a major impact on exports. It provides brief reviews of the key issues in national policy development, the policy environment for foreign direct investment, the national incentives regime, the exchange rate, the availability of credit and the labour market.

NATIONAL POLICY DEVELOPMENT – AN OVERVIEW

2.2 **Botswana is well known for its stable and consensual political environment.** It has free and fair democratic elections every five years and the effective rule of law. In addition, Botswana has earned a reputation for a prudent fiscal and monetary policy, and was recently awarded the highest sovereign credit rating in Africa by both Moody's and Standard and Poor's.

2.3 **In contrast to the experience of many other developing countries, Botswana has generally adopted market-friendly approaches to government intervention in the economy (BOB, 2000).** Upon Independence the Government assumed a major role in the provision of infrastructure and social services, since the private sector either did not exist or did not have the capacity to deliver in those areas (e.g. power, water, telecommunications, basic health, basic education). However, the Government refrained from engaging in a command-type economy and encouraged the development of a private sector to assume a more prominent role in the economy. Prices are generally allowed to reflect market conditions, with few restrictions on prices in the private sector (fuel prices are controlled). The policy principles for the pricing of government goods and services are intended to achieve both efficiency and equity objectives. Public goods and services may be subsidized for needy target groups, while cost-recovery applies to provision beyond basic needs.

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[6] Lesotho Garment Industry Sub-sector Study for the Government of Lesotho - 2001 - *Salm et al.*

2.4 **Botswana has a long tradition of adopting consensus-based national development plans.** These plans are developed with an extensive consultation process and cover almost all aspects of social and economic life. Upon adoption they guide the implementation of projects and programs and are funded through the annual budget process (MFDP, 1996). As well as explaining the general principles on which policies are based, the plans incorporate quantitative targets for resource allocation. Parliament endorses not only the general policies and priorities of the plans, but also the programme of Government expenditure that it sets out. Their preparation and implementation represent a concerted effort to ensure that Government's actions at all levels are consistent with its major and minor goals. The plans also serve as a guide and input for the preparation of District and Urban Authority Development Plans.

2.5 **Government has been successful in avoiding extreme boom and bust economic cycles (Gaolathe, 1997).** A key element of Botswana's macroeconomic strategy has been the accumulation of government savings during the good years, which could be drawn upon during economic downturns (Harvey and Lewis, 1990). Another key element has been the policy to re-invest most of the returns from the mining sector to develop the rest of the economy (BIDPA, 2002). Monetary policy is formulated with the objective of maintaining a low and stable rate of inflation and seeks to achieve a stable real exchange rate at a level which is supportive of the international competitiveness of local producers (see exchange rates section below). Monetary policy aims at maintaining healthy and prudential levels of international reserves and unrestricted access to foreign exchange for international transactions (BOB, 1998).

2.6 **The Government has drafted a Competition Policy**, which has been circulated and discussed at various forums, and is in the process of developing a competition law. A draft is being prepared by the Attorney-General's Chambers. Effective competition policy and implementation are essential complements to an open trading regime.

Citizen Economic Empowerment

2.7 **Botswana's policy towards Citizen Economic Empowerment involves empowering citizens to control increasing proportions of economic activity in the country by enhancing their skills, resources and opportunities to participate in productive enterprises.** The citizen economic empowerment strategy includes financial intervention to assist local business activities; enterprise development for citizens; marketing strategies for locally produced goods and services; promoting harmonious industrial relations; job creation; and training and education that is responsive to skill requirements in the economy.

2.8 **Citizen economic empowerment has driven a wide number of Government schemes, and is a major strand to government policy.** It has led to the development of the Small Scale Financial Assistance Policy (FAP), the special Credit Scheme for Small, Medium and Micro Enterprises, the Local Procurement Programme, and the Reservation Policy (see Table 2-1). Such programs may divert resources and entrepreneurship towards sectors serving the domestic market – typically small-scale business activities and non-tradeables (e.g., housing and personal services). Further, there are risks to Citizen Economic Empowerment becoming a form of hidden protectionism in its influence on economic policy. Considerations over citizen empowerment may explain some of the delay in dealing with the most pressing economic reform issues identified in this and other recent reports on Botswana, such as land allocation, work permits and privatisation. For example, the initial acquisition of serviced industrial land on state land is restricted to citizens, resulting in major delays for overseas investors in obtaining land. It is important that government policies learn from international best-practice in empowering citizens – the approach taken to citizen empowerment in other countries such as South Africa may not be the most appropriate for Botswana because of its unique historical circumstances.

2.9 **The following principles could be followed to minimise such risks**:

- Strategies for empowerment should always be based on a clear understanding of who holds the power and who are the disempowered.
- Entitlements do not breed empowerment, but rather breed vested interests and rent-seeking behaviour, often by the better-off. Providing incentives to make a better living and opportunities for doing business are more powerful tools of empowerment.
- The citizen economic empowerment process cannot be isolated from global economic and political shifts. Global competitiveness and WTO rules must be kept in mind. Empowerment schemes should not undermine economic efficiency, nor should they lead to a new raft of restrictive regulations.
- Over-protection and excessive handholding do not lead to empowerment: empowerment flourishes in a more competitive and less regulated business environment.
- Economic empowerment cannot be imposed from above. It has to be based on grassroots development. Self-empowerment is the core of any real empowerment.
- Empowerment schemes and rules must be transparent.
- Citizenship does not convey the right to be shielded from the consequences of making economic decisions.
- Creating new jobs leads to more citizen economic empowerment than providing preferential treatment for citizens in filling existing jobs.
- Education is a fundamental empowerment tool. Therefore, the empowerment role of education and training has to be emphasised.
- Interventions in the financial sector to address the special borrowing needs of certain segments of society should ensure that the financial sector remains sound and competitive, and that any channelling of resources to targeted sections of society is done in an efficient and transparent manner. Ultimately, such intervention is a fiscal issue for government to finance, not a banking issue *per se*.

The availability of economic data

2.10 **There are a range of data constraints that overcoming them would help to enhance the quantitative analysis of trade and competitiveness issues.** First and foremost, there has been a two-year delay in accessing reliable trade data. Second, there are major weaknesses in the quality of services export and import data (paragraph 1.22). Third, good quality data on productivity would help to identify possible sources of inflationary pressures and the underlying reasons for lack of competitiveness. Fourth, the calculation of a producer price index (PPI) for Botswana would facilitate the calculation of an REER index that is consistent with good international practice. Botswana's REER calculations should, as far as possible, use PPIs for trading partner inflation, rather than consumer prices indices.

RECOMMENDATIONS - NATIONAL POLICY DEVELOPMENT

- Government to finalise development of competition law (paragraph 2.6).
- Government to review procedures and capacity for collecting trade data at the CSO. The Ministry of Finance and Development Planning must find a way to integrate the software of its two departments that collect (Customs) and analyze (Trade Statistics in CSO). Data should be made available in a usable format on a quarterly basis. One solution could be to contract out this role. There should be a concerted effort involving the CSO, Bank of Botswana and other relevant departments to reconcile and improve the quality of services exports information. Further, estimates for productivity and a producer price index would facilitate the calculation of valuable economic data (paragraph 2.10).
- Government to adopt best-practice principles for Citizen Empowerment Schemes as set out in paragraph 2.7 onwards.

BUSINESS REGULATION AND FOREIGN DIRECT INVESTMENT POLICY

2.11 **The overall legislative, legal and institutional framework for investment in Botswana is generally good (FIAS, 2004).** Foreign exchange controls, which had not been very restrictive anyway, were progressively liberalised during the 1990s and were finally abolished in 1999 (BOB, 2002). Taxation is relatively low by regional standards. Employment legislation is non-restrictive, although a number of concerns have been expressed about the rules governing the employment of non-citizens. Property rights and the rule of law are well-enforced (World Bank, 2004). The Companies Act has been modernized to a high standard to enforce appropriate disclosure of accounts in accordance with generally accepted international accounting practices (BEDIA, 2004).

2.12 **Botswana has traditionally maintained a very liberal and open foreign investment regime (BIDPA, 2004e).** Restrictions only apply to limited sectors and activities, and have the objective of protecting local entrepreneurs. The only sectors in which FDI is specifically not permitted is in “small scale” business activities (e.g., an investment of under US $15,000 in the manufacturing sector) and some retail trade services and manufacturing (see Reservation Policy, Table 2-1). The state continues to own and control the key utilities for communications, power and water (Botswana Telecommunications Corporation, Botswana Power Corporation and Water Utilities Corporation, respectively); but it is committed under the Privatisation Policy to privatising, under appropriate regulatory frameworks, such entities, including having limited foreign involvement, especially as strategic partners, in these sectors (ROB, 2000b).

2.13 **The business environment in Botswana has been assessed by the World Bank Group in their report on Doing Business (World Bank, 2004)**. This uses a set of indicators that can be reasonably measured and compared across some 145 countries reviewed by the World Bank. The key indicators used help to measure the ease or difficulty of operating a business, including: starting a business, hiring and firing workers, registering property, getting credit, protecting investors, enforcing contracts, and closing a business. These show that Botswana has achieved a relatively good environment for doing business, but that compared to the best international practices found in the OECD countries, Botswana still has some substantial room for improvements:

- Botswana has favourable labor market legislative conditions for businesses.
- The ease with which businesses can secure rights to property is measured by the number of procedures necessary to transfer a property title from the seller to the buyer, and the time and the costs as a percentage of the property value. In Botswana, it takes 69.0 days to register property, compared with the regional average of 114.0 days and OECD average of 34.0 days.
- Botswana scores well above the region, and quite favourably compared to the OECD countries in indicators on accessing credit (measuring credit information available).
- Botswana scores well above the region, and almost as good as the OECD countries in measurements of the degree to which investors are protected through disclosure of ownership and financial information.
- The cost of enforcing contracts is 24.8 percent of the debt value in Botswana, compared with the regional average of 43.0 percent and the OECD average of 10.8 percent.
- The Recovery Rate for resolving a bankruptcy in Botswana measures the efficiency of foreclosure or bankruptcy procedures. The cents on the dollar claimants recover from the insolvent firms is 50.9 percent in Botswana, which compares very favourably with the regional average of 17.1 percent, but substantially below the OECD average Recovery Rate of 72.1 percent.

2.14 **Other studies have identified and raised concerns over a number of constraints to business and foreign investment:**

- **FIAS (2003) also identified delays and inefficiencies in the registration of companies.** In order to start a business in Botswana, entrepreneurs can expect to go through 11 steps that take over 108 days on average, at a cost equal to 11.3 percent of gross national income (GNI) per capita. In the region, there were also 11 steps to launch a business; but, these only took 63 days on average, while costing 225.2 percent of GNI per capita. In the OECD countries, there were only 6 steps needed to start a business, which only took 35 days and cost 8.0 percent of GNI per capita. Thus, Botswana comes out poorly in terms of days required to start a business, both in regional terms and compared to the more developed countries; but the country does not appear so bad in terms of cost.

- UNCTAD (2003) concluded that "FDI (in Botswana) has always been welcomed and fairly treated, and has benefited from an excellent business climate". **However, it expressed concerns over a draft Investment Code which suggested a possible tightening up on conditions for FDI.** UNCTAD (2003) raised a major concern that the proposed new entry restrictions would prohibit the entry of FDI in small-scale projects below a certain size. As a result of the comments by UNCTAD and others, the Government withdrew the draft Investment Code for review, with a view to putting forward a coherent strategy to guide the formulation of wider policy measures to attract and benefit from FDI. A revised investment code that has dropped the restrictions on smaller-scale FDI is now under consideration.

- **Government has recently made efforts to reduce the number of days and the number of steps involved in setting up a business in Botswana**, and is reviewing the Industrial Development Act with the intention of simplifying the industrial licensing system. Unfortunately, a revised Act which reduced the number of bureaucratic steps was submitted to Parliament in 2004, but was rejected on the basis that it was felt to undermine the power of elected local authorities. The UNCTAD and FIAS studies also pointed to a number of sector-level licenses – many without a clear purpose – which delay the start-up of businesses.

- **UNCTAD (2003) and FIAS (2004) highlight the impact of restrictive work permits for expatriates** (see paragraph 37) and difficulties experienced by foreign investors in acquiring land (see Box 2-1).

Box 2-1: The Land Problem and Exports

- The shortage of serviced industrial land is a major constraint to further industrial development in Botswana - in particular the acute lack of commercial land in Gaborone. This is in part caused by constraints in the land allocation system – especially the time required for the rezoning of land from agriculture to commercial or industrial use and the registration of interests in land titles. Progress has so far been slow in responding to these concerns. Government remains the primary provider of serviced land. As the demand for land increased, Government has failed to provide enough serviced land to users. Encouraging private developers to provide serviced land to industrial investors may be one option to solve this problem. Government sharing infrastructural costs with private users may be another option.

- Imani (2004) noted that city and town councils heavily cross-subsidise rateable land to provide free services, such as refuse collection, road maintenance, etc. to the Self Help Housing Areas that comprise about 80 percent of residential plots by number (if not by area). This leads to higher land costs for business. They also note that initial acquisition of serviced industrial land on state land is restricted to citizens (or via the Botswana Development Corporation), and that this market distorting policy has been overcome in Gaborone over the last five years as the Catholic Church has converted a large share of its formerly agricultural freehold land into commercial and industrial freehold land on offer to any purchaser, regardless of citizenship (Imani, 2004). The problem of land availability is compounded by the shortage of state land in some urban areas; Gaborone, for instance, is surrounded by tribal land, some of which has been developed for commercial and industrial purposes, but for which regulations on transfer of ownership are even more restrictive, especially for non-citizens. It is extremely difficult to convert tribal land to state land.

- For the IFSC companies, office space rent per square meter (psm) is about fifty percent more in Botswana (US$17 psm) than in Mauritius (US$11 psm) and South Africa (US$12 psm), but less than in India (US$20). Office space in well-established BPO centres of the developed countries, such as Ireland, Canada and Singapore, is much more expensive than Botswana, ranging from US$35 to US$70 per square meter. The additional office space that is becoming available in Botswana should soon make Gaborone quite competitive with respect to office space availability.

- Current land tenure arrangements in Botswana have been identified as a regulatory constraint inhibiting ostrich production, and especially limiting new entrants into the industry. Botswana has three categories of land tenure namely, tribal, state and freehold land. Freehold land comprises only 6% of the total area and it is privately owned. State land (23%) is owned by the state and used as national parks, forest and game reserves. No settlements are permitted in the reserves.[1] Tribal land makes up 71% of the total Botswana land area and exclusive use is only available through leases awarded by the various Land Boards. It is not clear who qualifies for access. Furthermore, there are producers who already have land allocated to them, but have difficulties in changing its use from arable production; for example, to ostrich farming.

- Delays in the allocation of land was a major constraint for two of the five vehicle and auto parts firms surveyed for this report. To illustrate, one firm producing automotive batteries wanted to expand its operations by manufacturing inputs so that it can avoid some of the imported inputs. One major input which the firm has been importing is lead. It constitutes sixty percent of the total imported inputs. By establishing a plant to break used up batteries to take out the lead and recycle them after treatment will save millions of pula for the company and create a domestic base for further integration. The company has applied for land allocation five years back and is still waiting for a response from the government (Pillai, 2005). In contrast, the background study on the textiles sector conducted for this report notes that factory shells suitable for apparel and textile manufacturing are available at reasonable rental rates.

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RECOMMENDATIONS - BUSINESS REGULATION AND FOREIGN DIRECT INVESTMENT POLICY

- Government to convene seminar with key stakeholders to monitor implementation of the recommendations of FIAS 2004 report (paragraph 2.14).
- Government to finalise revisions to the Industrial Development Act with the intention of simplifying the industrial licensing system (paragraph 2.14).
- Government to expedite approval of a revised investment code that drops restrictions on smaller-scale FDI (paragraph 2.14).
- Government to expedite reforms to land allocation issue (paragraph 2.14).

2.15 **Botswana has bilateral investment treaties with a number of countries, including, *inter alia*, China, Germany, Malaysia and Switzerland, and is in the process of negotiating further treaties (BEDIA, 2003b).** Botswana does not give preferential treatment to investors on the basis of their home country. There are no restrictions on the remittance of profits or the proceeds of disinvestments (BEDIA, 2003b). Botswana has never expropriated a foreign investment. Foreign investors have full recourse to the court system (UNCTAD, 2003). Because of its high levels of liquidity and significant foreign exchange reserves, Botswana permits foreign firms to invest through non-FDI forms: for example, through loans from the domestic market.

THE INCENTIVES REGIME

2.16 **This section deals more specifically and in more detail with the policy frameworks for general or sectoral incentives that impact heavily, but are not targeted exclusively on exports.** Note that a discussion of specific concessions for exporters is taken up in Chapter 3 of this study.

2.17 **Botswana's previous focus on sectoral incentives has changed over the past decade.** Government has rightly adopted a more even-handed approach between sectors and focused on providing the right environment and incentives economy-wide. Previous incentives that Botswana employed from the 1970s to the 1990s were mainly focused on agriculture and manufacturing, sectors which were viewed at the time as the major potential engines of growth that could provide jobs and higher incomes for substantial numbers of Batswana. Because of Botswana's small domestic market, Government incentive regimes have traditionally not singled out export, as opposed to import substitution, activities for support, other than the provision of duty-free inputs. This was based on an assumption that emerging manufacturing industries, as well as non-beef agricultural activities, would, by necessity, be directed at substituting for imports or export-focused.

Box 2-2: Does Botswana's reliance on diamonds suggest a more 'activist' role for government?

- If Botswana is indeed suffering from a variant of 'Dutch disease', does this justify greater government intervention to maintain Botswana's non-diamond export sectors? At some point, the net foreign exchange flow from diamonds will decline and the Government needs to prepare for this. The range of options fall somewhere between two polar extremes: that some jobs in the productive sectors must be preserved against the time that they become viable and are needed for economic survival; or that this time is so far in the future that it is neither desirable nor feasible to shore up for the whole period sectors that are not currently competitive. The beef sector is a good example. While the sector is currently facing bleak future prospects, this could be a sector in which Botswana has a comparative advantage and could be competitive in the long-term when diamond revenues fall.

- However, the record of governments in choosing and promoting productive sectors is not good, hence the second 'polar extreme' may not represent a viable policy option for government. In East Asia, Costa Rica, Chile and Mauritius, for example, governments strengthened the capacity of local producers to produce for export through various factor market interventions (e.g., technology training, infrastructure, research support) and of specific institutions, arrangements and incentives for exporters (Helleiner, 2002). The positive experience of some successful countries that have used extensive government intervention in the productive sector is matched by many more examples of government incentive schemes and interventions that failed to lead to significant export growth and resulted in damaging and inefficient domestic market distortions and substantial drains on public funds and revenue losses to Government (Nathan Associates, 2004). And for many of the successful export-orientated developing countries the export incentives adopted just served to offset the anti-export bias of other domestic incentives and the regulatory framework. The case of Costa Rica is also illuminating. After making extensive use of export incentives for non-traditional exports via tax credits, duty-drawback systems and export promotion, the current policy focus is that a 'third generation' of reforms should focus on overall competitiveness – in particular increasing infrastructure investment, greater private sector participation, opening up of trade in services and various other measures (Rodriguez, 2002).

- Botswana's own experience with the use of positive incentives in the past as a means of promoting productive and sustainable diversified development indicates the country has achieved only limited success, the cost-effectiveness of which is open to serious doubt. Indeed, Government attempts to provide incentives to selected sectors may indirectly undermine other potential growth sectors. For example, tax incentives for the manufacturing sector discriminate against the potentially more promising tourism sector.

- There is scope for more Government activism in removing constraints to growth, and to providing the necessary support infrastructure to major potential growth sectors. A proactive Government role in a growth sector – for example in developing Botswana's tourism potential – does not necessarily require artificially distorting relative prices and investment incentives in the economy by offering sector-specific tax breaks or other specific incentives. Further, more 'activist' policies to building up human and financial capital are needed, and will help to ensure that the economy has the flexibility to withstand the external account shock of falling diamond revenues, when such shocks occur.

- Greater activism should not mean direct involvement by Government in business, including through open-ended subsidization of selected companies. Export diversification should not be used as justification for failing policies. Similarly, arbitrary trade protection to support local enterprises is the least efficient way to support these sectors. Further, while Government has used public expenditure in part to build up private sector supply capabilities through tendering a large share of public expenditure programs to the private sector, this policy may have run its course. Moody's (2004) suggest that the high level of government expenditure and the size of the public sector may be stifling the development of a vibrant private sector. The extent to which the public sector is "crowding out" the private sector goes beyond the remit of this report, but merits further research and analysis.

2.18 **Botswana has adopted numerous policies and programmes over the years to foster economic growth and employment creation.** In addition to major thrusts aimed at promoting agricultural activities, not only in cattle production but also in small-stock, dairy, poultry, cereal, horticulture, beekeeping, fisheries, and forestry, Government has implemented initiatives aimed at developing local entrepreneurship through financial loans and grants, training, mentoring, advisory services, input subsidies, tax incentives, protection and preferences in a wide range of sectors. Table 2-1 sets out some of the more prominent industrial development incentive programmes initiated since Independence.

Table 2-1: Summary of Major Incentive Programmes

Incentives	Objective	Year of introduction	Present status
1) Financial Assistance Policy (FAP)	FAP provided capital and labor grants based on labor employed. It was the largest incentive programme implemented in Botswana. It provided tax holidays, made up-front capital grants based on employment targets and had other grants to partially cover the costs of unskilled labor and training for up to five years of the project's life. The up-front capital grant could be re-claimed if the target was not achieved. Originally, FAP focused on goods (manufactured and non-traditional agricultural products), but it was gradually extended to include some services, such as tourism.	1982	An evaluation of the scheme by BIDPA (1999) found a high failure rate and large-scale abuses, wastage and high costs per job created. On the basis of the BIDPA review, the Policy was terminated.
2) Citizen Entre-preneurial Develop-ment Agency	CEDA supports the development of citizen businesses through funding, training and mentoring. CEDA provides financial assistance in the form of interest subsidised loans of 5 percent interest for small projects and 7.5 percent for large projects for citizen-owned businesses targeting the export markets. It also provides training and mentoring. There are currently no performance targets for CEDA; hence, it is difficult to judge the impact of this subsidy and support. CEDA's mandate is entrepreneurship development. Export activities, however, are not a major part of its support activities and lending. The Government also provides assistance through the Citizen Entrepreneur Mortgage Assistance Equity Fund.	2001	FAP was replaced by the **Citizen Entrepreneurial Development Agency**, which commenced operations in 2001 (ROB, 2002a).
3) Selebi-Phikwe Regional Develop-ment Project	Established to stimulate economic development in the area around the copper-nickel mining town, as a means of providing sustainable income generating opportunities beyond the day when the mine would close down. The Project offered tax breaks and tax rates which were lower than normal corporate tax.	1988	The Project was phased out in 1996; and its elements were merged with the general industrial promotion scheme of the Ministry of Trade and Industry.

Incentives	Objective	Year of introduction	Present status
4) Local Preference Scheme	Gives local producers preference in the supply of goods for government contracts.	1976	The Local Procurement Programme was introduced in 1997 following a substantial revision to previous schemes. To qualify for the programme, it was schemes. To qualify for the programme, it was stipulated that all firms should achieve a minimum of 25 percent local content and also contained the conditions that i) the business should be licensed and employ not more than 200 people; ii) The business should have an annual turnover of between P200,000 and P5 million; and iii) the business should have an investment in productive machinery of between P5000 and P5 million. The program requires that 30 percent of annual public purchases of goods and services be from eligible firms, which can be either local or foreign owned. The Government initiated a Quality Improvement Project designed to improve production quality of local manufacturers, especially small and medium-sized enterprises, to enable them to participate more successfully in public procurement. Two pilot sectors were selected: garments, and concrete products. Entrepreneurs are provided with non-financial support. The Project is about to be extended to other industries. Botswana does not intend to become a member or observer of the WTO Plurilateral Agreement on Government Procurement.
5) Reservation Policy	In order to promote participation of Batswana in economic activity, certain economic activities are reserved exclusively for citizens and companies which are wholly owned by citizens. The policy has been implemented in respect of certain commercial activities in manufacturing and construction activities. Entry restrictions, intended to protect and promote local entrepreneurs apply to a limited number of small scale activities[7] serving the domestic market (BIDPA, 2004e). Small-scale mining is limited to citizens.	1982	Continues with minor modifications. Government has relaxed the Reservation Policy to allow for joint ventures between citizens and foreign investors to manufacture products that have been reserved to citizens and medium sized companies wholly owned by citizens. In terms of the Trade Act, 2003, as opposed to the old Trade and Liquor Act, the Minister has yet to issue regulations stating which trading activities are reserved for citizens or majority citizen owned companies.

2.19 **Recent programs such as the local procurement program and the reservation policy have an anti-export bias, although it is difficult to calculate the extent of this bias.** They obviously have a valuable objective in terms of developing local entrepreneurship. However, they divert resources and entrepreneurship towards sectors serving the domestic market – typically small-scale business activities and non-tradeables (e.g., housing and personal services). The procurement program enables companies to seek protected government contracts instead of such entrepreneurship being directed towards export contracts. However, a detailed examination of the combined impact of these schemes on the anti-export bias is beyond the scope of this study, and would suffer from a lack of ongoing data monitoring of their impacts by the programs concerned.

[7] Cement and baked bricks, bread baking, school furniture, uniforms, protective clothing, burglar bars, and sorghum milling.

General Incentives – Taxation

2.20 **Botswana is a low-tax jurisdiction**, with low general rates of tax and investment tax credits in various forms, including the ability to grant a tax holiday, favourable tax rates or exemption and special deductions for employment or training.

2.21 **It has not been possible to undertake even a simple financial cost-benefit analysis of whether tax incentives for inward investors engaged in export business yield a positive net financial return to Botswana.** BEDIA, CEDA, IFSC and MTI do not collect the data needed for such cost-benefit analysis. In the past, simple financial and economic cost-benefit analyses were done under the Financial Assistance Policy to assess whether tax incentives for inward investors engaged in tradeable goods business yielded a positive net financial return to Botswana; however, this has been discontinued.

2.22 **The main direct tax incentive is a very low statutory tax rate of 25 percent that applies equally to domestic and export companies, while a 15 percent tax regime applies to manufacturing and International Financial Services Centre (IFSC) entities.** Alongside Mauritius, this is the lowest rate in the region. A recent study (Nathan Associates, 2004) compared marginal effective tax rates (METRs) of standard company and dividend taxes in SADC. Mauritius had the lowest rates, followed by Botswana, Namibia and Zambia, all with METR's of less than 35 percent. The METR model used in the Nathan Associates study shows a decline in Botswana's METR from 34 percent to 10 percent because of tax incentives. Personal income tax is also low in Botswana, with the maximum rate at 25 percent.

2.23 **As noted above, preferential tax rates apply to the manufacturing sector and to offshore financial services companies approved by the IFSC.** The company tax level for companies is 25 percent, which includes 15 percent basic company tax and 10 percent "additional company tax" (ACT). Company income tax for manufacturing business was reduced in 1996 from 25 percent to 15 percent, although companies have to obtain approval from the tax authorities based on a case-by-case assessment and a strict definition on what constitutes real 'manufacturing', which can be a lengthy procedure. IFSC companies are strictly limited to export activities – this is discussed in more detail in Chapter 3. The Botswana Meat Commission is subject to a tax based on turnover, which approximates to a manufacturing company income tax rate of 15 percent although is much less favourable if the company is making losses.

2.24 **Botswana has rightly not offered large tax incentives to attract investments that are location-specific**, such as diamond mining or other mining activities, although it does offer mining and agriculture companies full deductability of capital expenditures with unlimited loss carry-forward compared to the standard 5-year limit. Taxation regimes for major mining investments are negotiated on a case-by-case basis. Other mining companies are covered by a variable tax rate formula in which the tax rate is based on their rate of profit. Subject to the discretion of the Minister, royalties of 5 percent for the sales value of precious metals and 3 percent of other non-diamond mined products are payable. The new formula-based variable tax regime for the mineral sector was designed and adopted from best international practice as a way of making it easy, transparent and predictable for the other non-diamond mineral projects. This was intended to promote FDI in other mineral developments.

2.25 Dividends are taxed at 15 percent, although this is offset by any payments made under the 10 percent additional company tax (ACT).

2.26 **With Parliamentary approval, the Minister of Finance and Development Planning may provide income tax concessions by a Development Approval Order or by a tax agreement.** The concessions are in the form of reduced rates of tax on profits or withholdings or favourable treatment of expense deductions. Tax agreements and Development Approval Orders are granted on a case-by-case basis, although with regard to manufacturing, the process for reducing corporate tax is relatively well defined. Under the Development Approval Order, zero corporate tax rates can be available to investors for a period of 5 to 10 years. Access to this tax concession is by application. While tax holidays may be obtained through a Development Approval Order, unlike other countries in the region, very few Development Approval Orders have been granted in Botswana. The process for granting Development Approval Orders is underlain by strong "citizen empowerment" considerations.[8] The tax relief provided by Development Approval Orders may be in the form of additional deductions and allowances in the ascertainment of the chargeable income, for different periods of the duration of the project's life. Tax experts see tax holidays as a weak instrument for stimulating growth and investment, hence the authorities are right to use this instrument sparingly, if at all.

2.27 **There are also taxation allowances available to all investors.** These include;

- Capital allowances with a maximum allowance of 100 percent of the cost.
- On plant and machinery, the annual allowance that can be claimed by the investor ranges from 10 percent to 25 percent of the cost.
- An initial allowance of 25 percent on new buildings and improvements on existing ones used in an industrial business.
- A 200 percent deduction on the cost of training employees. Such training should be approved by the Commissioner of Taxes.

2.28 **Unlike a number of other countries in region:**

- **Botswana does not provide accelerated depreciation allowances.** Such allowances have had a mixed impact in other countries, and would further compound the capital bias already in existence in Botswana. Botswana does not operate an investment tax credit, which is used in Mauritius and Mozambique. Nathan Associates (2004) advocate greater consideration of this instrument by other countries in the region. It argued that investment tax credits were the most cost-effective way of raising industrial incentives (the METRs). Botswana has tried to have an employment creation bias in its industrial promotion programmes (e.g., FAP). An investment tax credit is inherently a capital-intensive biased incentive programme; hence, it would further accentuate a possible bias towards capital over labour already inherent in subsidized loan programs in Botswana.

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[8] The Minister must have regard to the following when considering applications: (a) the number of citizens likely to be employed under the project or activity; (b) facilities for training and imparting of skills to citizens; (c) provisions for the eventual replacement of non-citizen employees by citizens; (d) participation by citizens in the management of the business; (e) the degree of investment in the business of capital owned by citizens; (f) the area for the proposed project or activity; and (g) the likely effect of the project or activity in the development of other economic, industrial or commercial activities, and in reducing prices for consumer goods and service.

- **Botswana does not offer tax incentives tied to employment or wage costs.** Zimbabwean manufacturers can claim a 200 percent deduction on wages and salaries for new (additional) employees, while Namibia grants a 25 percent deduction for the cost of production line wages. Like many countries in the region, Botswana offers training incentives. All companies can claim 200 percent deduction (instead of 100 percent) from their taxable incomes for expenditure on staff training approved by the Commissioner of Taxes. This scheme has suffered from an almost zero take-up (see paragraph 2.66).

- **Botswana does not offer specific tax benefits (e.g., company tax reductions, tax holidays) to companies that export**, unlike most SADC countries (except Angola, Botswana and Lesotho). This is in line with the WTO Agreement on Subsidies and Countervailing Duties. Reductions or grace periods for profit taxes are considered an export subsidy in the WTO but countries with income per capita of less than $1000 are exempted from this WTO rule, hence the difference across SADC countries.

2.29 **To encourage the development of the Botswana Stock Exchange, all capital gains made on the disposal of shares listed on the BSE are exempt from tax.** The Bank of Botswana or any other bank or corporation wholly owned by the Botswana Government, any approved benefit, provident or superannuation fund, any building society, any approved mutual savings bank or mutual loan association, the stock exchange, and specified collective investment undertakings are exempted from tax liability altogether.

2.30 **The FIAS (2004) report pointed to the need for fine-tuning efforts in the administration of the Department of Taxes**, citing inefficiencies in tax collections and compliance and problems caused by the two-tier system of company tax. The Department of Taxes was found to be under-resourced and under-skilled which in turn is having a significant impact on tax administration in Botswana. They report that audit and enforcement strategies are virtually non-existent and a significant number of businesses appear to have opted out of the tax system altogether (e.g., non-registration, non-lodgment of tax returns, reluctance to pay outstanding taxes). The business community has expressed frustration with the poor technical skills of Department staff. These shortcomings are acknowledged by Commissioner of Taxes in the Department of Taxes Strategic Plan for 2002-2007, where (on page 17) the Commissioner states "*The Department is functioning under a sound legislative framework, but has limited capabilities in the area of investigation skills to deal with tax evasion, knowledge base to interpret tax laws, communication skills to deal with taxpayers and accounting and legal expertise in its workforce*".

Incentives Competition

2.31 **Regional competition in terms of the provision of incentives is fierce.** A broad variety of incentives are available in South Africa to local producers, and exporters in particular. Some of the incentives are subject to local-content requirements. Table 2-2 below compares the range of incentives available in selected countries in the region.

2.32 **Some investors complain that Botswana's incentives regime does not compare well to regional competitors.** Most existing incentive programs in Botswana are only available to citizens. For example, the auto-sector firms surveyed for this study felt that the low company tax regime was similar to Mauritius and was a poor substitute for range of incentives offered such by other regional competitors – such as South Africa's assistance towards marketing, its investment assistance scheme, low interest rates, tax holiday schemes, and medium term loan financing.

2.33 **SACU and SADC have an important future role to play in terms of harmonizing incentives.** However, minimizing harmful tax competition has been difficult even for more developed countries and regions. Competition between states in the US is particularly fierce. Only the EU has made progress, albeit limited. There is need to understand and be able to assess the cost-effectiveness of the various schemes, with a view to avoiding the worst ones. In general, tax competition is a negative-sum game – most research suggests that such incentives do not have a net positive impact on FDI flows (Nathan Associates, 2004). However, there can still be some case(s) for differential incentives, based on local conditions and the ability of countries with a stronger fiscal position to offer lower taxes.

Table 2-2: Type of investment incentives in selected countries

Country	Start-up Grant/ Allowance	Labour Grant	Training Grant	Export Processing Zones	Tax/Duties Exemptions/ Reductions	Subsidies on Buildings
Botswana	Yes	Yes	Yes	No	Yes	No
RSA	Yes	No	No	No	Yes	No
Lesotho	No	No	Yes	No	Yes	No
Swaziland	No	No	No	No	Yes	Yes
Namibia	Yes	No	Yes	Yes	Yes	Yes
Mozambique	No	No	No	No	Yes	No
Zimbabwe	No	No	No	Yes	Yes	No
Mauritius	No	No	No	Yes	Yes	Yes
Kenya	No	No	No	No	Yes	No
Malaysia	No	No	No	No	Yes	Yes
Singapore	Yes	No	No	No	Yes	No

Source: BIDPA (2000)

RECOMMENDATIONS - THE INCENTIVES REGIME

- Government to consider adopting uniform 15 percent tax rate for all business activities. This would make for a much simpler, easier to administer regime which would still place Botswana in a highly competitive position internationally. It would remove the implicit discrimination against the tourism sector, and would eliminate on shore and offshore distinction for tax purposes (see paragraph 3.51). This would of course require an estimation of the budget impacts and an assessment of how this would fit into overall tax policy. Non-mineral income tax, which includes personal income taxes as well, accounts for about fifteen percent of total government revenue, although it is becoming more important as mineral revenues stagnate and SACU revenues decline (paragraph 2.23).

- Consideration should be given to removing the need for a manufacturer to apply to the Ministry of Finance and Development Planning in order to be eligible for the reduced tax rate. The current system whereby an application is lodged, which is then carefully scrutinized, seems to add an unnecessary layer of bureaucracy. Companies could be permitted to take a position as to their eligibility (in line with self-assessment principles), with the Department of Taxes to be able to review any claim (paragraph 2.26).

- The reservation policy should be reformed. As it stands, it is a restriction on trade in certain areas of commercial activity (Table 2-1: Summary of Major Incentive Programmes and paragraph 2.12).

- Government, in cooperation with SACU and SADC, should establish a clearer role for cooperation to avoid tax competition in the region (paragraph 2.32).

- Government to commission cost-benefit review of industrial rebate for raw materials imported for production for sales into domestic market (paragraph 3.75).

- As part of a broad export diversification strategy, Botswana should reconsider and appraise any broad or specific subsidies (especially interest rate subsidies) for non-tradeable goods activities. For example, CEDA should evaluate project proposals with a view to their net benefit to Botswana, using shadow prices that place a premium on tradeable goods (paragraph 2.19).

- Central Statistics Office or another suitable agency or think tank to conduct a review of ongoing impact monitoring of existing government support programs, tax incentives and reservation policies set out in Table 2-1: Summary of Major Incentive Programmes.

The Macroeconomic Policy Mix

2.34 **In recent years the macroeconomic framework has "tightened" considerably, making macroeconomic conditions considerably less conducive to private investment and productive activity.**[9] All three of the main policy contributors to the macroeconomic environment – fiscal, monetary and exchange rate policies – have contributed to this tightening, and are likely to have contributed to declining growth rates of the non-mineral economy.

2.35 **Fiscal policy has been progressively tightened since 2001.** While this may not be immediately obvious from an examination of the "headline" budget balance (in recent years the budget deficit has been around 2-4 percent of GDP, compared with surplus budgets in the 1990s), a more detailed consideration of the impact of the fiscal position on the domestic economy reveals a tightening. The *domestic* budget balance (revenues raised from domestic sources minus domestic expenditure[10]) is always in deficit, so that government is a major net source of aggregate demand; however, the deficit has been falling steadily, from 34 percent of (non-mineral) GDP in 2001/02 to a projected 28 percent in 2005/06, so that from a domestic perspective, the fiscal position has become less expansionary. Contributing to this, the growth rate of government spending has been cut sharply, while the ratio of domestic revenue to non-mineral GDP has risen sharply, from 13% in 2001/02 to 20 percent in 2005/06. This is a necessary adjustment from a fiscal sustainability perspective, but it nevertheless has a dampening effect on domestic economic activity, by reducing the fiscal contribution to aggregate demand.[11]

2.36 **At the same time that this fiscal contraction has been taking place, the impact of monetary and exchange rate policy has also been contractionary.** The real effective exchange rate (REER) has appreciated (see below). This has been compounded by rising **real interest rates**; for instance, the benchmark real interest rate on Bank of Botswana Certificates (BoBCs) has doubled from around 3% in 1999 to 6% in 2004, taking the real prime bank lending rate to around 9%. Given that this has coincided with a period of generally easing monetary conditions internationally, with declining interest rates, Botswana's real interest rates are very high by current international standards (Table 2-3). The real interest rate on prime lending rate increased from 0.52 percent in 1993 to 8.48 percent by June 2004.

2.37 **High interest rates have coincided with very high lending spreads.** The lending spread increased from five percentage points to seven percentage points from 1993 to 2004. As banks managed to increase their lending spread over the past decade, their income has increased sharply. Return on Equity (ROE) of the banking system tripled since 1995 and reached to about 40 percent. These rates are about three times of African averages and makes Botswana's banks some of the most profitable in the world. The loan-to-deposit ratio declined over the last decade. The household sector is the largest borrower, and the share of households in total credit has increased consistently. Business services is the second biggest user of bank credit (albeit quite a distant second), with about 15 percent of

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[9] Macroeconomic tightening is a change in the policy stance acting to reduce aggregate demand.

[10] The domestic budget balance therefore excludes foreign sourced revenue, such as taxes on mineral exports, and government spending on imported goods and services.

[11] However, this has no direct impact on export production, and could actually help by reducing the incentives for producing non-tradables.

total credit. The share of manufacturing in total credit has almost halved over the last ten years to 5.5 percent in 2004. Similarly, the share going to agriculture more than halved during the same time period. There is an active debate over whether the availability of high-yielding BOBCs has reduced the incentives for inter-bank competition.

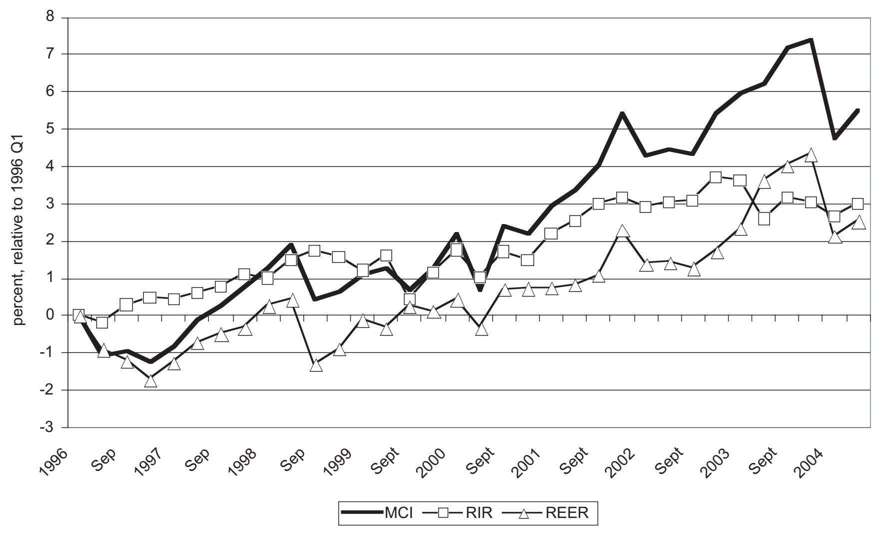
Table 2-3: Regional Interest Rates (nominal)

	Prime			T-bill and Botswana BOBCs			Deposit rate		
	Botswana	**Namibia**	**RSA**	**Botswana**	**Namibia**	**RSA**	**Botswana**	**Namibia**	**RSA**
1999	14.81	16.70	15.50	11.98	11.53	10.70	9.19	8.57	10.00
2000	15.75	15.90	14.50	12.71	9.62	10.20	10.18	7.63	10.65
2001	15.75	14.00	13.00	12.51	9.13	9.20	9.81	6.48	9.25
2002	16.75	17.50	17.00	14.03	11.93	12.27	10.15	8.96	12.52
2003	15.75	12.00	11.50	12.74	7.35	7.31	9.49	6.88	7.40
2004	15.75	12.50	11.50	12.99	8.07	7.83	8.32	6.38	7.71

Source: Bank of Botswana, Bank of Namibia and South African Reserve Bank. 2004 figures as of June. (Namibia and RSA T-bill rates are 3-month T-Bill rates, Botswana rates are 3-month BOBC rates)

2.38 **The combined impact of tightening monetary and exchange rate conditions can be assessed by way of a Monetary Conditions Index (MCI)**. This can be calculated as a weighted average of the real exchange rate and the real interest rate (RIR). As the Chart shows, there has been a steady rise (tightening) in the MCI in recent years, due to both an appreciating REER and rising RIRs.[12]

Figure 2-1: Monetary Conditions Index



Source: Econsult

[12] The weights used in the MCI calculation are 2/3 for the RIR and 1/3 for the REER where, following convention, the REER enters as percentage change, and the RIR as the percentage point change, from the chosen base period. While the weights should, in principle, be derived from an empirical analysis of the impact of interest rates and the exchange rate on economic growth, the coefficients chosen here are consistent with those estimated for other small open economies. The absolute value of the MCI has no economic significance; what is important is movements over time, and the value at a particular point in time relative to the chosen base period.

2.39 **The cause of tightening conditions can be identified as follows: domestic inflation is high (relative to the average inflation rate of Botswana's trading partners).** This, when combined with a fixed nominal exchange rate (NEER), causes the real exchange rate to appreciate; in an attempt to restrain inflation (and prevent real appreciation), monetary policy is tightened, causing real interest rates to rise.[13] This policy combination is not immediately supportive of export diversification, nor has it managed to bring inflation down to a level that would ensure REER stability. This raises the question of whether the policy framework and the response to high domestic inflation (the fixed exchange rate and high interest rates) is appropriate.

2.40 **On one level the policy combination is unsustainable:** it is well known that the combination of a fixed exchange rate and an active monetary policy cannot be maintained when an economy has no control on capital movements and is integrated with international financial markets. The fact that Botswana has been able to maintain such a policy combination since the abolition of exchange controls in 1999 is due to the country's relatively limited integration with international capital markets;[14] however, this situation will gradually be eroded over time as domestic financial markets and international linkages develop. A choice will therefore have to be made between introducing exchange rate flexibility along with an active monetary policy, using interest rates to combat inflation, or maintaining a fixed (but adjustable) exchange rate along with a passive monetary policy, whereby interest rates would follow international levels; putting the choice differently, it is between using the exchange rate or a monetary variable as the nominal anchor for prices.

2.41 **This is a medium term policy issue that needs to be addressed. However, there is a more immediate question of whether the current policy combination is working to the disadvantage of export diversification, and whether an alternative policy combination might be more favourable.** As noted above, one problem for the non-mining economy in general is that all three spheres of macroeconomic policy have been tightened at the same time (fiscal, monetary and exchange rate policy). The result of "looser" macroeconomic conditions might have been higher inflation (the impact of a larger devaluation and/or lower real interest rates), although it is not possible to say how much higher. Not enough is known about the quantitative relationship between exchange rates, interest rates and inflation to answer this with any degree of certainty (or indeed between those variables and output and exports); however, there is good reason to believe that inflation is not particularly sensitive to domestic interest rates, given that prices for the majority of items in the consumer price index basket are more influenced by other factors (import prices; government regulated/administered prices). Hence the proportion of overall inflation that is influenced by domestic demand conditions may be quite small, making interest rates, which have their impact through demand conditions, somewhat ineffective.

2.42 **Can it therefore be argued that the economy would have been better off with lower interest rates and an earlier or larger devaluation?** i.e., can it be argued that the policy framework has focused too much on bringing down inflation and not enough on variations in output, employment and growth?[15] It is beyond the scope of this study to answer this

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[13] See the Bank of Botswana's various *Monetary Policy Statements* (www.bankofbotswana.bw) for explanation of the policy framework and stance.

[14] Due in part to the maintenance of exchange controls on capital movements by South Africa.

[15] If monetary policy is characterized as responding to a Taylor Rule (where interest rates depend on deviations of inflation and output from desired levels), the weight on output deviations in the monetary policy reaction function has been too low relative to the weight on inflation deviations. While in the long run the Phillips curve is vertical and there

question. Further research is needed on these broad macroeconomic challenges, and in particular on the quantitative relationship between exchange rates, interest rates and inflation in Botswana.

2.43 **The following section reviews on aspect of the above discussion** – the impact of exchange rates on export diversification.

Exchange Rate Measurements

2.44 **The determination of the pula exchange rate is based on a fixed peg to a basket comprising the SA rand and the SDR, although this peg is adjusted regularly.** The basket weights are undisclosed, but are related to trade patterns, the latter broadly comprising merchandise imports and non-diamond exports. The reason for excluding diamond exports is that they are considered to be relatively insensitive to the exchange rate.

2.45 **From an analysis of exchange rate developments between 1990 and 2004, it is evident that while the formal policy is a fixed peg, there have been adjustments to the value of the pula vis-à-vis the peg.** These include publicised step-devaluations, as well as undisclosed "technical adjustments". The result was a steady downward trend in the nominal effective exchange rate[16] (NEER), measured using non-diamond trade weights, during 1990-2000. Between 2000 and early 2004 the NEER appreciated, although this appreciation was reversed by the 7.5 percent devaluation of February 2004.

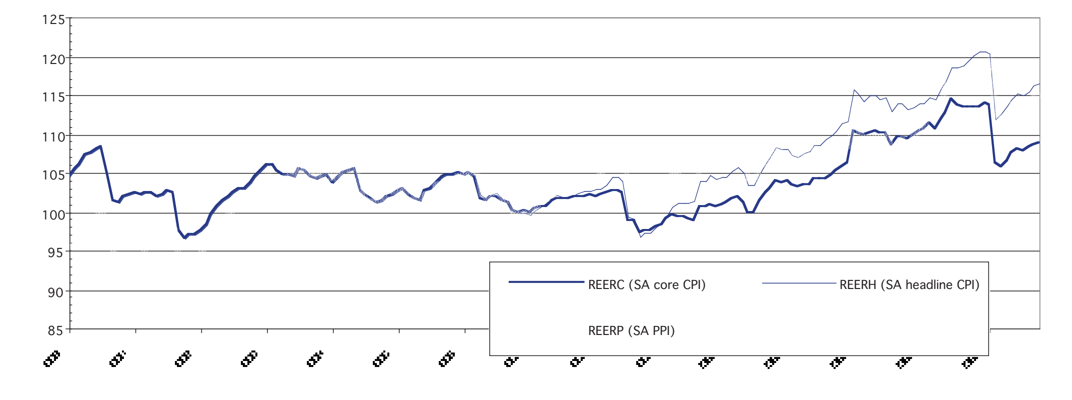
2.46 **Given that the exchange rates of the currencies in the pula basket fluctuated considerably against each other, bilateral pula exchange rates were much more volatile than the NEER.** In particular, the pula depreciated significantly against the SDR currencies between 1990 and 2001, and appreciated slowly against the rand. Between 2002 and 2004 the trends were reversed, with rapid and substantial appreciation against the SDR currencies and depreciation against the rand.

2.47 **By late 2004, the REER was some 10 percent higher than its average value during the stable 1993-2000 period. The magnitudes of the changes depend on the inflation measures used in the REER calculations, but the broad trends are the same.** A number of different REER indices were calculated for this study, based on alternative price indices for South Africa. REER movements vary across REER measures, although the broad trends are similar. The REER was fairly stable between early 1993 and 2001, in that it fluctuated within a fairly narrow range with no clear upward or downward trend. Nevertheless some upward movement can be seen from 1999 onwards, and regardless of the measure chosen, the REER rose steadily for five years between early 1999 and early 2004, appreciating by 12 percent or more over this period.

is no trade-off between inflation and output/employment (you cannot buy higher employment by accepting higher inflation), in the short run there is a trade off.

[16] The NEER represents a weighted average of bilateral nominal exchange rates.

Figure 2-2: Real Effective Exchange Rate Measures, 1990-2004



Source: Bank of Botswana

2.48 **The analysis of Botswana's equilibrium real exchange rate undertaken in the background study on exchange rates for this report suggests that by 2003-4 the REER – measured from the perspective of the whole economy – was overvalued, relative to its equilibrium value, by some 10 percent.** While the analysis should be taken as preliminary, the results are credible in relation to similar analyses undertaken for other countries in sub-Saharan Africa. The sharp appreciation of the whole-economy REER in 2002-3 is striking, and provides strong evidence of REER overvaluation given that it is highly unlikely that the economic fundamentals that determine the equilibrium REER would have changed so much in a short period of time.

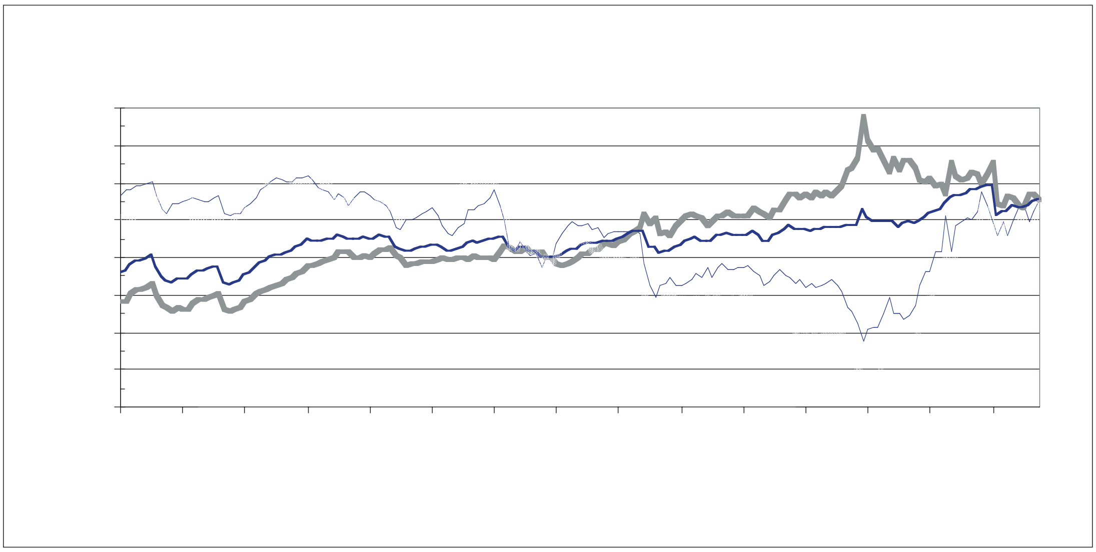
2.49 **The appreciation since 2000 can be attributed entirely to rising relative prices and not nominal appreciation – in particular, high inflation for non-tradeable goods and services.** Botswana's inflation is significantly higher than average (and weighted) trading partner inflation. The cause of Botswana's relatively high inflation rate is not easy to identify. It is unlikely to be due to loose monetary policy, as interest rates have been relatively high in real terms in recent years. The origin appears to be non-tradeables prices, which have risen faster than tradeables prices in recent years. Between 1997 and 2004, non-tradeables prices grew on average by 9 percent a year, and tradeables prices by 7 percent a year. Besides being a classic symptom of Dutch Disease, it is also consistent with a lack of productivity growth, especially in the parastatals sector, whose outputs – such as utilities – tend to be important inputs to other productive sectors. Low (relative) productivity in the parastatals sector would, therefore, tend to push up overall prices. Unfortunately, data on productivity is poor, so no firm conclusions can be reached.

2.50 **The source of real exchange rate appreciation is higher inflation in Botswana than the average of trading partner inflation; in particular, high inflation for non-tradeable goods and services.** During the 1990s, the steady depreciation of the NEER was sufficient to offset the higher inflation differential and keep the REER relatively steady. Between 2000 and early 2004, however, the NEER appreciated and this, combined with rising relative prices, has caused the REER to appreciate. After taking account of the February 2004 devaluation, REER appreciation since 2000 can be attributed entirely to rising prices in Botswana relative to trading partners and not nominal appreciation (unlike, for instance, South Africa, where real appreciation between 2000 and 2004 was almost entirely driven by nominal exchange rate appreciation). While the causes of this inflation are not well-established, it is thought likely that it is due, in part, to deteriorating productivity growth in

Botswana relative to trading partners. Addressing more deep seated issues related to productivity and other factors that determine competitiveness (such as the legal and bureaucratic obstacles to investment identified in FIAS (2004)) is therefore a critical element to boosting competitiveness.

2.51 **As with nominal exchange rates, bilateral RERs were much more volatile than the REER.** The long periods of real depreciation against the SDR currencies and appreciation against the rand between 1993 and 2001 were reversed between 2002 and 2004; the latter period saw very extreme movements in bilateral RERs, with the pula appreciating in real terms by 80 percent against the US dollar.

Figure 2-3: Bilateral Real Exchange Rates of the Pula 1990-2004



Impacts

2.52 **The exchange rate is one of the key determinants of competitiveness of an economy.** There is a strong and unanimous acceptance that real exchange rate competitiveness combined with fiscal discipline and macroeconomic stability is central to the success of any reform program (Elbadawi, 2002). High performing East Asian Countries managed to maintain stable exchange rates and avoid overvaluation. Elsewhere in Africa, a competitive real exchange rate is also associated with non-traditional export success. A time-series study on Tanzania found a statistically significant relationship between real devaluation and non-traditional export growth (Helleiner, 2002). This has been described as a major factor in their success. Ndulu and Semboja (1995) found that a depreciation of the REER had a significant and positive impact on exports of manufactured goods in a number of countries. In a cross-sample of SSA countries, Sekkat and Varoudakis (1999) show how exchange rate management matters for export performance, with misalignment playing a more detrimental role than exchange rate volatility. Soderling (2000) estimates that the reduction in manufacturing exports due to policy-induced REER overvaluation may have been as high as 45 percent in the 1980s in Cameroon. In sum, all countries that have been successful in promoting manufactured exports have avoided real exchange rate overvaluation.

2.53 **Has this real appreciation had an impact on export diversification in Botswana?** There is some evidence that non-traditional exports are affected, as would be expected, by the real effective exchange rate. The period of recent REER appreciation has coincided with a slowdown, and indeed a possible reversal, of non-traditional export growth in merchandise exports. Correlation coefficients indicate a negative relationship between real non-traditional exports and the level of the REER, regardless of the REER measure chosen. Regression analysis provides tentative support for such a relationship, although the statistical relationship is not conclusive because the results are not particularly robust to changes in data and model specifications. In a previous study, Granberg (1998) suggests that the exchange rate has not been the only, or even the major, factor at play in promoting exports compared to other policies. He suggests that moderate devaluations and appreciations have tended to have marginal impacts on trade. This is, in part, because of inflation pass-through effects, which are high in a small open economy with a relatively high import content such as Botswana. For a detailed discussion of possible "Dutch Disease" effects see Box 1-1.

2.54 All of the sectors reviewed for this study have important structural issues that need to be addressed if there is to be strong future export growth. The overall level of the exchange rate did not figure prominently among those interviewed. **For most, if not all, of the sectors covered, and especially for individual firms, bilateral nominal (and real) exchange rates (notably pula/US dollar and pula/rand) appear to be of more importance than overall effective exchange rates.** This reflects the structure of trade at the company/sector level, but also the volatility of bilateral exchange rates, where movements have been much greater than in the overall pula exchange rate. Since a large share of Botswana's non-traditional exports are destined for South Africa, the Rand-Pula exchange rate is particularly important. Given the magnitude of bilateral RER changes, and the speed of reversal of longer-term trends in 2002-04, it would be most unlikely that individual firms have not been affected, perhaps quite drastically. At the very least, *bilateral* RER volatility will have increased the uncertainty facing firms and this is likely to have contributed to reduced investment in non-traditional export activities (indeed, in the production of tradeable commodities more generally).

2.55 In further detail:

- **Diamond mining:** this constitutes approximately 85 percent of merchandise trade, but is largely immune to the Pula exchange rate because of the particular configuration of the world diamond market. Rough diamond exports are priced in US dollars, hence an exchange rate change will simply change the pula-denominated profit levels and budget transfers of Debswana in the short-run. Although the longer-run implications will depend on the pass through effects on input prices and purchasing power, input costs, at present, are relatively small compared to profit levels.

- **Beef exports:** the exchange rate is not a major determinant of demand for exports to the EU (constituting about two-thirds of beef exports by value) so long as the break-even price of Botswana beef is not above the EU price level, which is currently approximately 57 percent above world prices. However, for beef exports to South Africa (about one-third of exports by value), the exchange rate will have a strong impact.

- **Textiles:** again, the exchange rate will have most impact at the margin where Botswana textiles hit the protected US market price threshold. Given that the sector as a whole has significant exports to South Africa, as well as the USA and Europe, movements of the Pula against the USD and the euro will tend to be offset by movements against the rand, due to the operation of the Pula basket mechanism, so the sector as a whole (if not individual firms) will be insulated to some extent against bilateral exchange rate volatility. However, overall real appreciation of the Pula will undermine the viability of the sector.

- **Tourism:** the exchange rate has a very immediate and direct impact on the relative costs of tourism in Botswana compared to other regional competitors offering a similar product. Over half of the holiday visitors come from RSA; 15.4 percent from elsewhere in Africa; Europe 17 percent; USA 3.7 percent and Australia 2.4 percent. In the upper market segment, prices are denominated in US dollars, while most imported input costs (with the exception of gasoline) are in rands; hence this segment is vulnerable to swings in the USD/ZAR exchange rate. In other market segments, prices are Pula denominated; hence, the Pula/rand rate is important, which tends to be more stable.

2.56 **It is important to note that this bilateral NER and RER volatility is outside of the control of domestic policy makers,** and results from the volatility of the exchange rate of the rand against the SDR currencies, particularly the US dollar. Botswana cannot escape this volatility, but can only alter the distribution of exchange rate volatility across firms and sectors. The use of the trade weighted currency basket serves to distribute exogenous exchange rate volatility in accordance with the current importance of currencies in total non-diamond trade.

THE LABOR MARKET

2.57 This study conducted a survey of 11 exporting firms to discuss a wide range of labor-related issues.

2.58 Unemployment rates in Botswana generally vary inversely with the level of education and training attainment (see Table 2-4), although this is not the case for lower levels of education according to the 2001 Census.

Table 2-4: Unemployment rates by level of training attainment, 2001

	Female	Male	All
No training	28.4	21.2	24.5
All certificates	14.0	7.4	9.9
All diplomas	4.5	4.2	4.4
All degrees	3.6	2.6	3.0
OVERALL	23.6	16.2	19.5

Source: 2001 Population and Housing Census

Foreign Personnel

2.59 There could be as many as 15,000 foreigners working in the private sector. Most non-citizens employed by manufacturing enterprises in Botswana have acquired their skills as a result of protracted on the job experience. Although there are unemployed Batswana with vocational qualifications, they generally do not have this level of experience-based expertise, which usually is directly related to very specific production processes and technologies. It is not the case, therefore, that nationals could replace most foreign workers from the open labour market, at least in the short term.

2.60 Not only are Batswana with the requisite skills generally unavailable, but enterprises are able to draw on a large pool of experienced production workers from South and South East

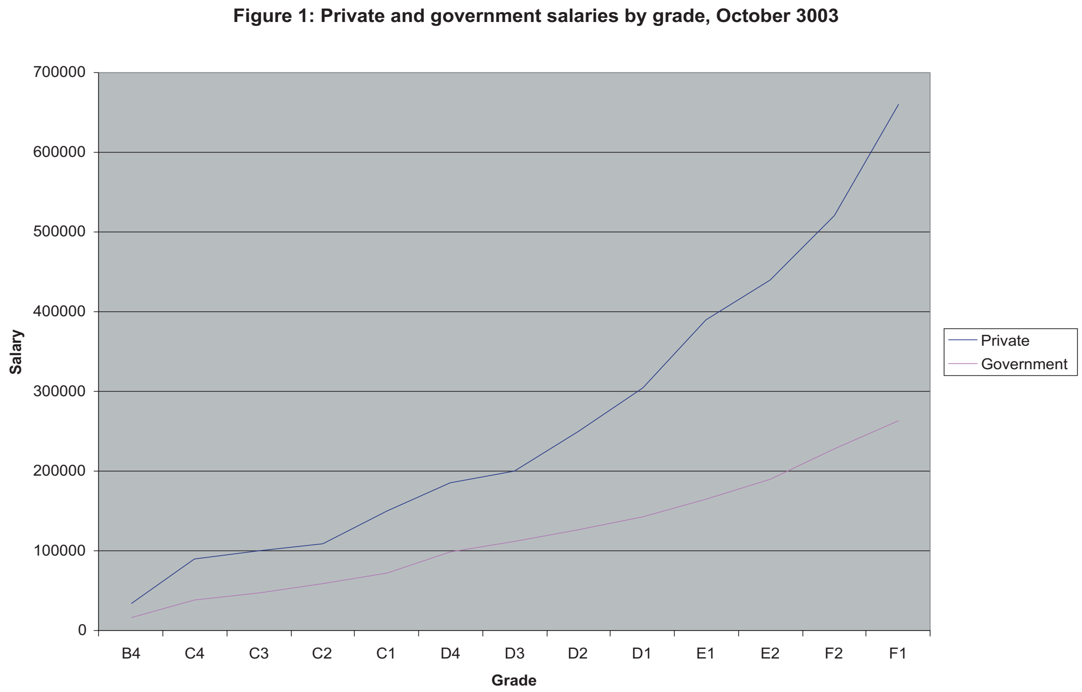
Asia, as well as neighbouring countries (most notably Zimbabwe and Zambia). More research is needed, but it appears that the salary costs of these expatriate personnel are not much higher than for locally hired Batswana. Experienced Zimbabwean skilled workers are 'good and cheap'. The total employment costs of supervisors and other skilled workers from South Asia are typically in the range of P3000-P6000 per month. Taiwanese technicians at one of the garment factories that were visited earn no more than US$800-900 per month. Some company respondents also noted that the salaries for professional staff are higher in Botswana than in South Africa.

2.61 Obtaining work and residence permits has been consistently identified as among the most difficult investment procedures in Botswana. The total backlog of work permit applications was 7474 in late 2004. The work permits are granted only after a labor market test (i.e., only if there are no suitable local candidates for the post) and a proposal for training of citizens to replace the non-citizens. The main bottleneck is in processing work permits at the Gaborone Regional Immigration Selection Board. However, temporary work permit waivers enable most foreign investors to circumvent unwieldy and bureaucratic work permit procedures. These have to be renewed every three months. Although this is a relatively straightforward process and can be done at District Labour Offices it causes uncertainty amongst employers and employees alike, and is a serious disincentive to the recruitment of some skilled expatriates. Of particular concern is the increase in the cost of obtaining work permits. Prior to 2000, the work permit application fee was P100.00, regardless of the number of working years. In 2000, it was revised to an initial P100.00 per application fee and thereafter P200.00 for every working year. In 2004, it was further revised to an upfront P600.00 for employees and P1000.00 for self employed applicants. A waiver fee of P100.00 was also introduced. Further, the cost of obtaining a visa was increased twenty-fold in 2004 from P25 to P500. Producers have complained that this has unreasonably raised the costs of obtaining labour.

Impact of the public sector

2.62 While public sector employment did dominate high and middle level labour markets during the 1970s and 1980s, this has been increasingly less so since the mid-late 1990s. In overall terms, the share of wage employment accounted for by central and local government was only 27.4 percent in 2001 according to Population Census employment data. Government introduced a national prices and incomes policy in 1972, whose main objective was to ensure wage restraint in the private and parastatal sectors. Private sector employers were legally not allowed to pay citizen employees more than the pay for equivalent occupations in the public sector, which impacted negatively on their recruitment and retention of middle and senior level citizen personnel. However, since 1990 private sector employers have not been subject to restrictions and public-private sector income differentials among skilled labour categories are now sizeable (see figure below).

Figure 2-4: Private and Government Salaries by grade October 2003



Source: BIDPA, 2004

Training and education

2.63 Botswana's education system was seriously neglected throughout the colonial period. However, by African standards, Botswana now has a well-resourced education and training system. The key education goal is that all children receive twelve years of good quality and relevant basic education. Enrolment rates for both primary and secondary schooling are very high. The growth in public expenditure on education has averaged nearly 15 percent per annum since 1997/98.

2.64 Most high-level personnel are trained at the University of Botswana. Total enrolments have grown extremely rapidly- from just under four thousand in 1992/93 to over 13,000 in 2002/03. However, science and engineering and technology account for only 20 per cent of enrolments. There was almost complete gender parity in enrolments in 2002/03. Because of supply constraints in tertiary education, a number of students are subsidized to study abroad. Including costs from Debswana, this costs Government almost P1 billion per year.

2.65 The vocational training system focuses mainly on pre-employment, time-bound technician and craft-level skills training for predominantly male primary and secondary school leavers at government-funded vocational training centres. In the absence of any systematic human resource planning, Botswana's training system has been essentially supply-driven with relatively limited involvement of employers in the development of course content and training standards.

2.66 Manufacturing enterprises rely almost totally on on-the-job training for both production workers and other staff. This level of isolation of manufacturing enterprises from the formal vocational system is the norm in sub-Sahara Africa. The National Policy on Vocational Education and Training (VET) of 1997 seeks to redress these weaknesses by creating an integrated, national VET system, rationalise courses and qualifications through the establishment of a national qualifications framework. The Botswana Training Authority and the Tertiary Education Council have been established to spearhead the reform process. However, progress to date has been limited and there are concerns that training provision will not become demand-driven. All registered enterprises can claim an income tax rebate of 200 percent on approved training activities. However, only one of the 11 case study enterprises has availed itself of this training incentive and is unlikely to do so in the future because 'the system is too bureaucratic'. This requires further assessment of the role and cost-benefit of tax credits in promoting training since government is also developing a Levy-Grant System and also offers a Student Grant-Loan Scheme.

Government Regulation

2.67 Labour relations in Botswana are generally good, especially compared with South Africa. The level of trade union membership is low as is the incidence of industrial action. The general consensus is that the minimum wage in the private sector has not seriously affected employment creation and productivity. Up until recently, many manufacturing employers were not unduly concerned about the minimum wage because their labour costs have been heavily subsidised as part of the FAP, albeit on a decreasing scale for a maximum of 5 years.

Future Labour Supply and Demand

2.68 A key issue is the extent to which export-oriented enterprises will have to compete for labour, and especially high and middle level personnel, with other industries, as well as the public sector. Future growth in public sector employment is likely to be limited as government seeks to control public expenditure and increasingly focuses on private sector development. The growing numbers of graduates from post-secondary training institutions will, therefore, have to be absorbed by the private sector.

2.69 The AIDS epidemic is projected to have a devastating impact on the labour force in Botswana. The overall adult HIV prevalence rate was 25.3 percent in mid 2004. However, only one of the 11 companies that were visited indicated that the AIDS epidemic has had a significant impact to date on their workforce, both in terms of morbidity (sickness) and mortality. The direct employment costs of the HIV/AIDS were also reported to be negligible in all companies. There is a similar result in the survey of auto companies also conducted for this study.

2.70 The absence of detailed and robust manpower planning means that no coherent set of projections exist with regard to occupational outputs from all the key post-secondary educational and training institutions. Projections for specific institutions have been made, but these are not part of a comprehensive national human resource development strategy.

RECOMMENDATIONS - THE LABOUR MARKET

- Government could develop a detailed and comprehensive national human resources development strategy, which focuses in particular on the occupational requirements of the key growth sectors in the economy. The development of a labour market information system is essential. Most importantly, this should include a comprehensive reform plan for the vocational education and training sector (paragraph 2.70).
- The company tax incentive for training requires reviewing and replacing with a more effective incentive for human resource development (paragraph 2.28).
- A resolution of the work permits issue is also required, possibly with permits based on a points system and/or a minimum number of permits awarded automatically for companies (paragraph 2.65). In particular, Government should reassess the cost of obtaining a work permit and visa.

3. THE ENABLING ENVIRONMENT II: EXPORT AND SECTOR-SPECIFIC POLICIES

3.1 This section looks at Government policy that is specifically targeted at exports, including sector-specific issues raised in the sub-sector studies, duty-exemption schemes for exporters, export promotion and private sector support institutions for exporters, trade finance and export credit insurance, incentives for the export of financial services, and licensing rules and standards for exporters.

SECTOR POLICIES - CASE STUDIES

The Beef Sector

3.2 **The Botswana beef export industry is in crisis.** The recent financial difficulties of the Botswana Meat Commission (BMC) – the Government's export monopoly for beef – have been exacerbated by temporary factors – notably the recent drought and the outbreak of foot and mouth disease (FMD) resulting, in all probability, from cross-border contamination. But while there may well be a cyclical upturn, these cycles are occurring around a deteriorating trend. There is no reason to suppose that without fundamental change on the supply side this trend will be reversed.

3.3 **This trend will not be reversed without fundamental change that would increase the number of cattle sold to BMC for export.** There appears to be a consensus that the fundamental problem facing the sector is that the cattle off-take rate is too low. This results in poor throughput (and low weights) for BMC either because prices on the domestic market are pushed up, making it more attractive than exporting, or simply because there are too few cattle raised with the intention of bringing them expeditiously to the market. Various studies suggest that there is significant scope for an increase in supply. However, over the period since 1992 prices paid to producers have generally gone up by less than the price paid by EU importers. This has occurred for a number of reasons – high costs arising from EU SPS measures and a rise in demand in the local market, that resulted in fewer cattle being sold to BMC and hence higher unit costs arising from falling throughput.

3.4 **European Union (EU) beef prices have not increased in real terms for three or four decades and are unlikely to do so in future.** In order to cope with the inevitable increase in costs incurred outside Botswana and the effects of rapid economic growth within Botswana, the beef sector would have needed continuous efficiency gains. There is no evidence that efficiency gains have occurred. Consequently, margins have been squeezed.

3.5 **The most important exported beef product for Botswana is chilled boneless beef.** Although this has seen modest growth over the last five years, Botswana lags behind Argentina (which has seen phenomenal growth from a very low base), Brazil, Australia – and also Namibia. Whereas Botswana's export value has increased by 6 percent, Namibia's has risen by 36 percent, with a 15 percent increase in unit value as against Botswana's 11 percent.

3.6 **BMC has sought to diversify its products and markets, but chilled and frozen beef to the EU remains the most significant.** In 1989/90 boneless chilled and frozen beef accounted for 80 percent of sales; in 2003 it was 77 percent (Fidzani *et al.* 1997; BMC 2003). In the same two years the share of exports destined for the EU was 69 percent and 57 percent respectively (*ibid.*). Hence export prices will have been strongly affected by changes to the EU market. The EU, and UK in particular, are overwhelmingly the most important export markets for Botswana beef.

3.7 **Eighty percent (by value) of chilled beef exports in 2003 went to the UK, and 22 percent of frozen beef - one concern is that the UK is a relatively slow-growing EU national market.** Germany is Argentina's main European market for chilled boneless beef, and Netherlands is Brazil's. Both countries achieve higher unit values in their main market than they do in the UK. Some degree of diversification within Europe, therefore, might be desirable for Botswana.

3.8 **Over one-third of BMC's output was sold either in Botswana or South Africa** in 2003 (19 percent in Botswana and 15 percent to South Africa) – a significant increase in share since the late 1990s. This is no doubt linked in part to outbreaks of FMD, since BMC is far from fulfilling its EU quota.

3.9 **The most urgent goal is to increase total exports.** On present trends the export of beef from Botswana to non-regional markets looks set to become uncompetitive within a few years. It would not disappear overnight, but BMC would suffer in a continuing and growing fashion from the corrosive effects of under-supply of cattle. Unless Government funds ever-larger deficits or takes more drastic action, such as the closure of one abattoir, its capacity to operate commercially will decline.

3.10 **The beef sector has long been a recipient of government support** in the form of artificially high producer prices, heavy direct subsidies into the sector, a very lenient tax system, heavy provision of livestock-specific infrastructure and trade protection. A major question facing policymakers is how long this support should continue, in what form, and alongside what reforms. Industry restructuring would allow time for either a substantial shake-up to the supply side or an orderly decline of the beef export sector.

3.11 **First, this study cautions against precipitate moves to privatise BMC – at least until the supply side has been improved.** The supply baseline is a throughput sufficient for only one abattoir, and standards might be compromised. On a practical level BMC could hardly be split up unless both the Lobatse and the Francistown abattoirs were maintained.

This will require Government to consider how to fund the deficit caused by the insufficiency of throughput to cover the fixed costs of both operations. Improving production efficiency is a long-run objective and is unlikely to resolve the current immediate profits crisis.

3.12 **Second, Government should consider continuing BMC's monopoly in terms of exports to Europe and other distant markets, but its removal for sales to South Africa.** At the present time it seems improbable that any organisation other than BMC would sustain substantial exports outside the region, and South Africa may be the market of the future since it will continue to be commercially viable for Botswana to export to South Africa for some time after it has ceased to be sensible to do so to non-regional markets. The relative balance of gains and losses between restricted-channel and fully competitive marketing is likely to be different for the South African and the European markets. Nimbleness in finding rapidly changing consumer niches will tend to be relatively more important for South Africa than it is for the EU. Negotiating power to ensure that the economic rents created by the Common Agricultural Policy (CAP) and trade preferences accrue to Botswana will be less relevant. Hence, it is possible that the balance of advantage lies with continuation of the BMC monopoly in terms of export to Europe and other distant markets and its removal for sales to South Africa.

3.13 **Third, there should be further consideration of the scope for liberalization of beef imports to increase supply to BMC.** In the industrial sector and advanced countries it is commonplace to have intra-industry trade – there is no reason in principle why the same should not occur in the agricultural sector, with the region importing larger quantities of forequarter meat partly in order to release hindquarter meat for export. The background study argues that government may have to choose between a partly export-oriented and a wholly domestically-oriented beef industry. If policymakers decide that Botswana should maintain beef exports, it may be necessary to increase the domestic incentives to sell to BMC for export. Increasing the costs of local slaughter (which government is doing) will go some way to reducing the prices that butchers can offer to cattle owners, but probably not enough. Only an increase in supply via imports will push down the price offered by BMC's competitors to a level at which its prices become attractive. In other words, cattle owners will have to accept lower aggregate prices either via Pula depreciation or via import relaxation if exports are to continue. Under this scenario BMC could also use its existing (and surplus capacity) infrastructure in moving chilled meat import from Brazil and government could offer a duty drawback as in South Africa.

3.14 **Two further issues in particular require further analysis.** First is the scope for penetrating higher value market niches in Europe. Since Botswana's beef is by and large "free range and organically reared" this could command a price premium, with good marketing. Second is the number of cattle in the country. The planned livestock study should provide a clear estimate. Better information is essential for policymakers – it would help to clarify issues such as off-take potential, linkages and the importance of cattle to the Botswana economy.

RECOMMENDATION(S) - The Beef Sector

- Upcoming Government livestock study to fully consider options for BMC privatisation, the removal of export monopoly (in particular to South Africa) and the potential for trade liberalisation to increase exports (paragraph 3.12).

The Ostrich Industry

3.15 **The commercial exploitation of ostriches began first in southern Africa towards the end of the nineteenth century when ostrich plumes became a principal South African export following gold and diamonds.** Feathers are no longer a fashion item but, to this day, ostrich products from southern Africa remain dominant in the world market. Significant demand for ostrich meat is relatively recent and on a generally rising trend; the longer-established demand for ostrich leather is generally stable.

3.16 **Within southern Africa, Botswana – home of the world's largest wild ostrich population – has lagged well behind South Africa, Namibia and Zimbabwe in developing the commercial potential of ostriches.** The Botswana industry remains at the infant stage. The number of registered ostrich producers (43 in 2004, with 35 said to be active) is at least on a level with Namibia and Zimbabwe, but there is only one abattoir, managed by the Botswana Ostrich Company (BOC), and there is no tannery as yet. BOC did not receive EU certification until August 2004. This is largely because the technical and capital demands are significantly greater than for cattle and other livestock production. Only domestically–reared ostriches are slaughtered and this means that ostriches are generally hatched on farms with incubation facilities and, to ensure survival, reared for three months before moving on to well-fenced farms. They are usually slaughtered at ten months in specially constructed abattoirs. Possible participation in leather production and manufacturing is a distant possibility, but it needs to be noted in any long-term strategy for the industry.

3.17 **Since access to the EU market was secured, the BOC has been able to supply around 3 tons per month to the wholesale trade in Belgium.** This is relatively small compared to the 350 tons supplied to the EU as a whole by South African exporters. The BOC is currently selling chilled rather than frozen meat. The costs of transporting the former are significantly higher, but it is considered important to build relationships with buyers and, with payment within a week of shipment, chilled meat products are helpful to cash flow.

3.18 **Although there are no records available from which to assess current profitability, production statistics may provide some insights.** In 2003, 570 birds were slaughtered. It is estimated that the abattoir slaughtered a total of about 1,115 birds in 2004. This is well below its capacity of 30,000 birds per year, but a sharp rise to over 5,000 birds slaughtered is anticipated, based upon the number of chicks already hatched.

3.19 **The government has provided considerable support to the establishment of an ostrich industry in Botswana.** This has been through the provision of a new state-funded ostrich abattoir and veterinary services and through its willingness to extend BDC loan facilities, despite failure to repay the initial loan on schedule.

3.20 **Several policies have been developed by government to guide the development of the industry.** One of these is the Ostrich Management Plan Policy of 1994, whose major objective is to promote sustainable commercial utilization of ostriches for the benefit of Botswana and its people. This policy makes a distinction between ostrich farming and ranching. A farm in this context is 'an adequately fenced property that houses adult breeding birds which produce eggs and chicks' for commercial purposes, whereas a ranch is 'an adequately fenced property on which eggs and chicks collected from the wild are raised for commercial means'. To promote the sustainability of the industry, the policy promotes ostrich farming over ranching. While the policy acknowledges that market forces should generally prevail, it also aims to promote value addition in the ostrich industry before products are finally exported. The establishment of the Botswana Ostrich Company (BOC) ostrich abattoir was a related initiative by government. Further, its willingness to extend BDC loan facilities to ostrich producers despite failure to repay the initial loans on schedule as noted above, has demonstrated continued support to the industry.

3.21 **The success of the ostrich industry depends upon the viability of the BOC as the sole marketing channel for ostrich products in Botswana.** The success of BOC itself will depend upon its ability to access world markets and negotiate prices which are attractive to producers. The company was formed by producers in 2000 and it has a 50 year lease on the Gaborone abattoir, which was built by the Botswana Development Corporation (BDC) at a cost of P14 million and handed to the Government of Botswana.

3.22 **Since beginning its operation, the abattoir has run at much less than full capacity due to low supply volume even though the BOC guarantees to buy all slaughter stock offered for sale.** As a result, it has been unable to service the loan it obtained from BDC. Despite the guarantee, the BOC attributes the low supply volume partly to the absence of anticipated meat export market opportunities, and claims that the situation has caused the closure of some farm-level production units.

3.23 **However, since the BOC was granted approval to export to the EU market in late 2004, it is hopeful for a positive supply response from both existing and new producers.** From the time the abattoir was opened in 2002 until it received EU approval in August of 2004, it had accumulated a stock of about 20 tons of ostrich meat, which it began selling in 2004 to the EU market, South Africa and Namibia. Sales to South Africa and Namibia were at below-cost prices, in order to dispose of the stock, and were possible because of ostrich meat supply shortages in these countries, following the outbreak of Avian Influenza in South Africa. Although there are no records to assess current profitability, production statistics may provide some insights. The abattoir is currently not operating profitably, despite the fact that, being multi-species, it also undertakes service-slaughters for beef processors in the country. The BOC anticipates that this situation will be redressed as the industry expands.

3.24 **The BOC pays the Botswana government export levies of P1.00 per kg of ostrich meat and P10.00 per square metre of un-tanned ostrich skin.** This amounts to on average P32 per bird, which reduces BOC's earning by about ten percent per bird. This charge is in accordance with the Wildlife Conservation (Hunting and Licensing) Regulations, which the Department of Wildlife and National Parks (DWNP) argues is necessary to promote value addition in the local industry. However, this still represents a tax which is likely to discourage value addition. For meat this represents a consumption subsidy at the expense of the exporters, and for the downstream processing of hides it is imposed at the expense of the ostrich farmers.

3.25 **Apart from the EU standards, there are several other measures which impact upon the ostrich products trade.** According to the government's Ostrich Management Plan Policy (OMPP), on-farm–ranch inspections are undertaken by the Department of Animal Health and Production (DAHP) or DWNP to ensure compliance. Several farm level practices have to be observed to ensure safety and to avoid disease. Additionally, there are specific farm design requirements that must be adhered to by each operator. The OMPP also leaves room for imposing the requirement that all exported products are tagged or marked as directed by DAHP or DWNP, thereby giving these departments the power to ensure compliance with product identification regulations in the export market. The OMPP also outlines strict importation and disease control rules.

3.26 **Current land tenure arrangements in Botswana have been identified as a regulatory constraint inhibiting ostrich production, and especially inhibiting new entrants into the industry**. Land is only available through leases awarded by the various Land Boards and it is not clear who qualifies for access; furthermore there are producers who already have land allocated to them, but have difficulties in changing its use from arable production, for example, to ostrich farming.

3.27 **In terms of technical support, the government has deployed its veterinary and meat inspecting staff to work full time at the abattoir, and has recently established a unit within the Ministry of Agriculture to deal with extension training for ostrich farming.** The BOC itself has also employed extension staff to provide advisory services to existing ostrich farmers and potential entrants into the industry. These services include the sourcing of inputs such as breeding birds and the arrangement of transport to the abattoir. The government also plans to establish an ostrich research station at Dibete. This will serve as a multiplication farm producing both breeding stock and chicks for sale to farmers; and the station will have a model farm to train farmers in ostrich rearing. Ostrich production has a high use of veterinary treatments, including anti-bacterial and wound sprays. These are imported from South Africa, although the price is subsidized at Government livestock clinics. Supplies are not always available however; and the costs of procurement from private companies, such as Agrivet, are relatively high.

3.28 **According to industry participants, CEDA has so far not been sufficiently forthcoming in funding ostrich farming projects.** Only 10 ostrich projects have so far been approved for funding, with none since the EU granted export approval. This may be for valid financial reasons, and should be addressed and negotiated at an industry level.

RECOMMENDATION(S) - The Ostrich Industry

- Government to eliminate the current ostrich export levy (paragraph 3.24).

Tourism Development

3.29 **Apart from its diamonds, Botswana's major natural comparative advantage is in its diverse and abundant wildlife and natural resources.** This includes the renowned Okavango Delta and Chobe River Plains in the North and the Kalahari Desert in the South. These resources are sought after by international tourists and complement the global trends towards greater environmental awareness and the need to experience nature in its pristine state.

3.30 **The number of tourists coming to Botswana increased by some 196 percent from 106,800 in 1993 to 316,847 in 2000.** The majority of holiday visitors came for wildlife and wilderness-based vacation. Over half of the holiday visitors come from RSA; the rest of Africa 15.4 percent; Europe 17 percent; USA 3.7 percent and Australia 2.4 percent. The European market grew the fastest between 1994 and 1998 at 24.7 percent, suggesting potential for further growth.

3.31 **Taking the figures for 'travel credits' as included in the balance of payments data as a (albeit inexact) proxy for tourism receipts, tourism accounted for approximately two-thirds of services exports and 3 percent of total exports of goods and services in 2002.** According to Visitor Arrival Statistics (Department of Tourism, 2004) tourism arrivals grew from 642584 in 1997 to 1 036 558 in 2002, an increase of 61 percent. However, it is difficult to provide accurate economic impact figures since the sector impacts across the economy and is not a separate item in the Standard Industrial Classification system. As such it is not clearly recorded in the national accounts. The World Tourism Organization (WTO) has devised a Tourism Satellite Accounting (TSA) system that extracts the value of tourism from the various sectors of the economy. The WTO is currently working with the Botswana Government (Department of Tourism) to devise a TSA for Botswana. This will in time provide a more accurate reflection of Botswana's tourism contribution to the economy. Government estimates in Table 3-1 suggest that tourism already plays a very significant role in the national economy compared to South Africa, with high visitor to population ratios and a major contribution to GDP.

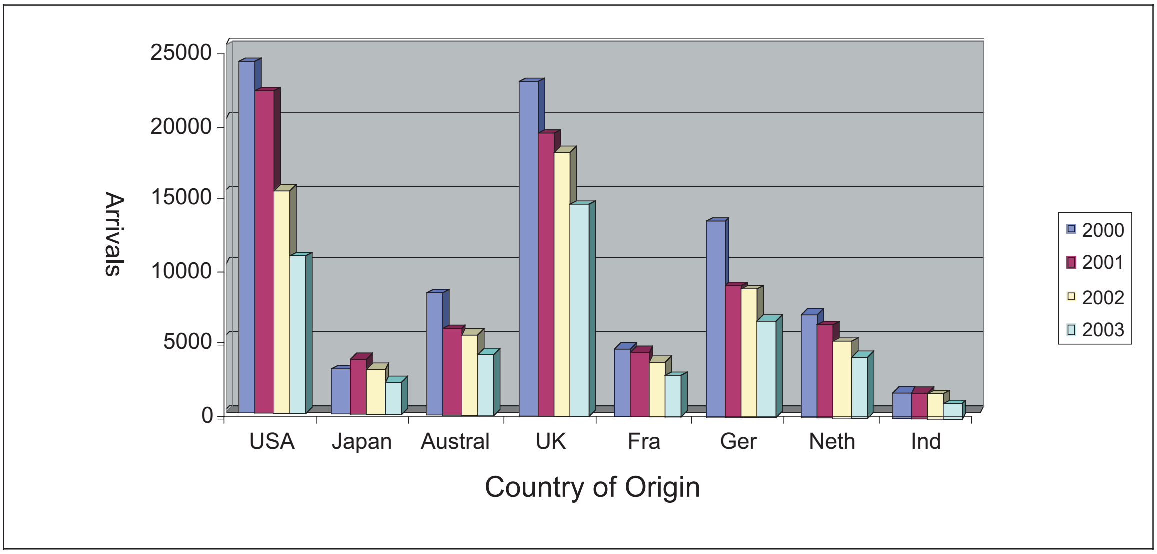
Table 3-1: Tourism in Botswana and South Africa

Indicator	**Botswana**	**South Africa**
Tourism as percent of GDP	3.2 percent - 4.5 percent	3 percent - 3.5 percent
Population per Visitor (2001)	1.6	7.7
Population per Holiday Visitor (2001)	5.4	19.4

Sources: Botswana Department of Tourism (1998; 2004); SA Tourism (2002); World Travel and Tourism Council (2002)

3.32 **A consistent decline in visitor numbers since 2000 is of serious concern.** However, comparisons with various countries in Southern and Eastern Africa indicate that most destinations in the area have experienced limited growth or even moderate declines since 2000. The decline in visitors is in line with global tourism trends, which have recently been in negative territory for the first time since the early 1980's as a result of global events such as terrorism, the Iraq war and SARS. However, one anomaly is that the South African tourism industry grew considerably in 2001/2 and moderately in 2002/3. This disparity in growth should be of concern since Botswana is closely related to South African tourism and should be able to capitalize on South Africa's tourism successes.

Figure 3-1: Botswana – Overseas Tourist Arrivals, 2000 - 2003



Source: World Tourism Organization, 2003

3.33 **In addition to the real decline in visitor arrivals to Botswana during 2000–2003, the proportion of overseas, high spending arrivals reduced from 10 percent of all arrivals in 2000 to 6 percent in 2003.** There has been a continuous decline in tourism arrivals from all major overseas source markets, with the USA market being affected most and suffering the greatest and most significant market losses. The impact of these trends on the traditional holiday tourism areas of the Okavango and Chobe should not be underestimated, as the majority (between 65 percent and 90 percent, depending on the source country) of overseas visitors visited Botswana for holiday purposes.

3.34 **It is clear that the political events in Zimbabwe have had a negative effect on the regional tourism circuit.** Tour operators are increasingly excluding Zimbabwe from tour packages and this "break" in the traditional circuit is having a negative effect on Botswana.

3.35 **According to the World Tourism Organization (WTO) signs of a global tourism recovery are evident**. Provided there is concerted effort to address constraints to tourism, Botswana should be poised to capitalize on this expected growth. It could also benefit from the development and promotion of a network of trans-frontier conservation areas in Southern Africa, the expected improvement in the situation in Zimbabwe within the next few years, and visitors to the World Soccer Cup to be hosted in South Africa in 2010.

3.36 **Botswana's Tourism Policy has generally been based on sound principles that have acknowledged the environmental value and vulnerability of the resource base.** A number of initiatives have been introduced under the policy, including the adoption of the Botswana Tourism Development Programme. The Botswana Government has produced a range of high quality policy statements and development frameworks during the past decade and a half. However, a background study on tourism prepared for this report found that there is a need to give greater recognition to the sector in policymaking, and to align the sector support institutions more clearly around a demand-led approach to tourism strategy. While the various frameworks provide some excellent proposals, there was a perception that these are not part of a clearly defined and prioritized implementation plan, with the result that it is difficult to gauge and monitor their implementation.

3.37 The Department of Tourism (DoT) has traditionally been responsible for all aspects of tourism development and promotion, including policymaking and planning, marketing, research and development implementation, training and regulatory matters. While the Department has made good progress in some areas during recent years, its impact has been limited by various factors. **There is a lack of adequate funding and capacity – the DoT has a tiny budget that leaves it with very little scope for program implementation once overheads have been taken care of.** The Department lacks a clear competitive marketing strategy. Further, the Department has to play the role of "referee and player" by having to regulate the industry while simultaneously being involved in promoting it. The Department of Tourism has regional offices in Maun and Kasane, but there are no local tourism associations in any of the tourism towns in Botswana.

3.38 **Despite the Government's policy objective of "modified high volume/mixed price" tourism, the perception remains that Botswana is a low volume/high value destination.** Botswana can sustain its national wilderness areas while increasing visitor numbers. An adherence to low volume/high value tourism and limited budgetary allocations have led to under-investment in essential facilities and infrastructure development for tourism (see Box 3-1). The independent, self-drive component of the international tourism market is growing continuously. The Botswana tourism sector should develop the required infrastructure and marketing packages to capitalize on this segment of the market. By using the main travel routes as "spines" and developing travel "loop" options of varying duration and length around them, including the lesser known areas and attractions, the country could become increasingly popular with independent travellers.

3.39 **Given the limited resources and capacity, the promotion of "Brand Botswana" as a global destination of choice has suffered during the past few years and marketing has been largely left to the private sector.** The recent appointment of the first Botswana Tourist Board bodes well for destination marketing. There is need for a well-researched, clear marketing strategy that will direct the future marketing focus of the Board and will inform Botswana's overall tourism policy and development thrust. The National Tourism Board would also encourage a more flexible operating environment and create an environment for external parties to advise on the tourism direction of the country. While relations between the private sector and the government are good, there is no formalized partnership agreement between the two parties.

3.40 The planned network of **Trans- frontier Conservation Areas** as promoted by the Peace Parks Foundation (the Kgalagadi Trans - frontier Park between Botswana and South Africa is the first of these) has the potential to establish the largest circuit of interlinked wilderness areas in the world and Botswana should ensure that it capitalizes as much as possible on this development.

3.41 **In Wildlife Management Areas, Customary Land Grants can be allocated for photographic and/or hunting safari purposes on a 15-year, right of first refusal concession basis, for which various conditions apply.** Concessions can either be granted to private entrepreneurs or to the communities who occupy the land. These communities can manage the land themselves or sub-lease it on a negotiated basis to private operators. Various conditions are negotiated upfront, such as concession fees, local community benefits, local employment ratios, environmental management measures, lodge design principles, etc. and concessionaires are evaluated during the course of their concession term with regard to the fulfilment of these conditions and overall management practices. This system appears to be very successful in encouraging sustainable development in wildlife management areas. Various private operators during interviews for the tourism background study felt the 15-year concession period did not provide them with adequate security of tenure. According to them, it roughly took 5 years for facilities and operations to become market ready (planning, development, operational training, market entry, etc.), that they then had 5 years of normal returns before having to refurbish and upgrade their investments. However, tourist accommodation facilities in the wildlife management areas do not require that permanent an investment (e.g., tents or lean-tos made out of local timber and thatch). Further, at present, investors already have the right to reopen the deal prior to expiration or, at expiration, to match any new offers for the lease that may appear - this is like getting a free *"put option"* in the security market. More research is needed as to whether the 15-year lease or something longer would encourage more visionary commitment from private investors and the government. If both partners are locked into longer lease periods, the question is whether this would lead to greater ownership of, and investment in long term community empowerment, capacity building, training, ownership/shareholder transfer and succession planning than at present.

Box 3-1: Infrastructure at Top Tourist Attractions

- The Chobe and Moremi Parks are the principal national tourism attractions, which together account for more than 90 percent of the primary market segments. But an adherence to the low volume / high value approach to tourism, coupled with limited budgetary allocations, have led to an under-investment in essential facilities and infrastructure development. Mounting pressure is being placed on the existing and limited infrastructure of these parks (and in particular Chobe) by the increase in day visitors and guests of the fast developing lodge industry located around the parks in Kasane and Maun. This issue is of particular concern since Botswana's overall tourism growth, as well as the economic development of the northern region, is largely dependent on the ability of these key Parks to accommodate and sustain growth in the number of visitors.
- Demand for Botswana's wildlife tourism products has increased substantially during the past 10 years, both as a result of a greater awareness of Botswana as a destination and the major growth of the Southern Africa tourism circuit. As a result tourism in and around Kasane and Maun has shown rapid growth. The tourism demand in these areas has resulted in significant increases in accommodation and other facilities, all of which are dependent upon the parks and wildlife areas for their existence and growth. As an example, the number of available bed-nights in Kasane grew by 61 percent between 1998 and 2003.
- These developments have placed major pressures on the parks infrastructure, as many visitors to Chobe and, to a lesser extent, Moremi stay in Kasane and Maun outside of the Parks and enter the Parks as day visitors, requiring an optimal wildlife experience within a limited time. Large proportions of these day trippers are from market segments other than the off-road, self travel camping market and do not have access to 4-wheel drive vehicles. They make use of mobile tour operators who ferry them into the parks for morning, afternoon or day trips. As a result specific areas such as the Chobe riverfront section and limited areas of Moremi face major pressure during specific periods of the year and times of the day despite previous extensions to the graveled road network in Chobe. The number of day visitors brought into the Chobe National Park rose by 360 percent between 1998 and 2003, from 4,333 to 15,587.
- It is apparent that the parks infrastructure in the major parks has not been planned and/or adapted to accommodate the changing market trends. The sustainable expansion of tourism will be largely dependent upon effective visitor management and the provision of infrastructure and facilities to accommodate these pressures. This is particularly relevant to the Chobe National Park, since it receives almost two-thirds of Botswana's parks visitors and the majority of day visitors.

RECOMMENDATIONS - Tourism Development

- The establishment of local tourism associations, which are affiliated to HATAB, in the main tourism centres is recommended. Local businesses of such associations could collaborate with the public sector on issues, such as the cleaning up and beautification of tourism towns, safety, infrastructure issues, community awareness and tourism information provision and reservations (paragraph 3.37).
- It is crucial that the DWNP be an active and key partner in the formulation and implementation of the national tourism strategy, be closely aligned to the Botswana Tourism Board, and that the Government allocate and manage its budget allocation and investment in the DoT and the DWNP as a holistic package, within a commonly agreed tourism development strategy (paragraph 3.37).
- Since the tourism success of emerging destinations is reliant upon the active participation and joint visioning of the government and the private sector, a formal partnership agreement should be considered, with both parties committing themselves to the implementation of a jointly agreed national tourism strategy that will guide tourism development over the next decade (paragraph 3.39).
- A formal partnership agreement between the government and the private sector should be considered. This could include funding cooperation and in this regard the establishment of a dedicated Tourism and Conservation Management Fund, to be funded through realistic levies charged at all tourism points such as parks, mobile tour operators, hospitality establishments, etc. (A tourism bed levy is currently being charged, but it is small and only applicable to accommodation enterprises. Park entrance fees have been adjusted over the years to be realistic) (paragraph 3.39).
- Further research is needed on the costs and benefits of allowing a longer concession term for tourism leases in wildlife management areas (paragraph 3.41).

The Financial Services Export Sector

3.42 **The Botswana International Financial Services Centre became operational in 2000.** IFSC has managed to attract twenty-one companies in a relatively short period. These include two leading Zimbabwean companies – one finances its agricultural seeds' supply business in nearby countries from the IFSC and the other utilizes the IFSC as a platform to extend its investment banking business in the region. In addition, Barclays, the United Kingdom Bank, has set up credit processing operation for its African operations. IFSC companies were estimated to employ a total of about 125 people by 2004, 80 of whom were local. The employment number is estimated to grow to 244, of whom 168 will be local, in 2005. Unfortunately there is no available data to isolate the impact of the IFSC upon the services trade balance.

3.43 **Botswana's IFSC is limited in scope.** It is by no means a full-blown offshore centre compared to a typical offshore jurisdiction that includes offshore banking, offshore corporations or international business corporations (IBCs), offshore insurance, special Purpose Vehicles (SPVs), asset protection, tax planning and avoidance, and in some cases money laundering. The current legal framework determining the scope of IFSC in

Botswana would make carrying out the usual activities related to offshore company registration and management companies very difficult, if not practically impossible. These make up the bulk of the business volume of many offshore financial centres. Moreover, these activities do not seem to be desired or targeted. The IFSC legislation has specified a small set of activities to be eligible for an IFSC license. Therefore, it would be unrealistic to expect the IFSC to attain company registration numbers and related employment levels in Botswana comparable to those of full-fledged offshore centers. For example, Mauritius has more than 20,000 companies registered with the Financial Sector Commission (FSC). It has more than 4500 people working in management companies and related functions that serve these offshore registered companies, and the regulatory fees collected from these companies are about US$10 million.

3.44 **Based on average financial sector salaries in Botswana, the monthly salaries of local staff employed by the IFSC licensed companies is estimated at about US$200,000 in 2005.**[17] In addition, the IFSC companies are expected to spend about $200,000 per month on rent, utilities and other services and the expatriate staff's monthly consumption of local goods and services in the country will be about US$250,000.[18] These figures indicate a total income generated by IFSC companies in 2005 of about $10 million. These figures together with other positive externalities associated with the activities of IFSC licensed companies - such as introducing modern management practices and technologies, upgrading of human skills, better integration with the global economy, etc show significant progress in a relatively short time. However, there is limited data with which to complete a full assessment of net impacts, which would also need to take into account the lost revenue attributable to the fiscal incentives.

3.45 **Botswana offers incentives specifically targeted at the export of financial services.** Botswana decided to set up an offshore jurisdiction to attract financial services companies as a means of diversification of its economy by way of changes in the Tax Law in 1999. These changes created special tax privileges for entities that are domiciled in Botswana, but carry out their business activities outside of Botswana. It was thought that special tax privileges coupled with a stable political system, orderly society, well-developed infrastructure services and close proximity to Johannesburg provide a good base to pursue such a developmental goal.

3.46 **The International Financial Services Centre (IFSC) was set up as a private entity (as a subsidiary of BDC) in April 2001 with a mandate to pursue this goal and establish a cross border financial services industry in Botswana and to act as the promoter, regulator and the administrator of an offshore jurisdiction.** IFSC recommends applications for IFSC tax status, which are then submitted to the Ministry of Finance and Development Planning (MFDP) for approval. All approved IFSC tax status applications also have to get regulatory approval. Although efforts have been made recently to streamline the application process so that the same information is used for both tax status approval and regulatory approval, this is still a burdensome and lengthy approval process (Mauritius has a 'one-step' approval process for its offshore centre). Companies that are registered and licensed by the IFSC and the appropriate regulator are entitled to a tax regime that is distinct from the domestic tax regime. The IFSC registered companies are subject to a guaranteed corporate tax rate of fifteen percent until June 2020.

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[17] These estimates are based on the IFSC's projections for the number of companies and employment for 2005.
[18] This number is an estimate based on interviews conducted for the background report on financial services.

3.47 **The criteria for IFSC Certification include being one of a set of designated activities**. Eligible activities for an "IFSC license" are mainly confined to back-office services for financial institutions and business process outsourcing (BPO), such as call centres, payroll processing (other activities can also be approved in a case-by case fashion). This includes: banking and financing in foreign currency; brokering and trading of securities denominated in foreign currency; investment advice; management and custodial services for collective investment schemes; insurance and related activities; registrars and transfer agency services; exploitation of intellectual property; development and supply of software for any of the previously noted activities; accounting and financial administration; and "any other allowable activities as deemed by the Minister of Finance". All services must be for clients based outside of Botswana and transacted in foreign currency. An "employment commitment" must be made in the application to be an IFSC entity.

3.48 **The IFSC's current focus is rather narrow and is essentially anchored around a preferential tax regime.** There seems to be a significant potential in Botswana to create an international capital market to allow foreign firms to raise capital in Botswana. If successful, Botswana could become a significant player in capital flows to African economies – this would require a broadening of the definition of eligible IFSC activities to remove uncertainty of applying under the discretion of the "any other activities" to the Minister of Finance. A transport and courier company recently wanted to set up a logistics hub in Gaborone. It ultimately decided not to – a key question is whether this decision would have been different if IFSC incentives were eligible to all service exporters, such as this company. Another example could be the construction business.

3.49 **There are significant challenges to promote business under the IFSC jurisdiction.** Many of these challenges – such as the cost of telecommunications – are common to other sectors and are mentioned elsewhere in this study. There are two specific challenges for the sector highlighted in the background study on the financial sector prepared for this report. The first issue is about overall legal and regulatory frameworks. The second issue is about strategic business focus.

3.50 **The presence of offshore financial services brings additional dimensions to the existing regulatory agenda by amplifying international interest in the financial regulation in Botswana.** The focus of the international scrutiny will be tax practices and money-laundering and combating financing of terrorism considerations. International organizations have been very active to monitor virtually all offshore jurisdictions and follow a "name and shame" policy by way of black-lists. The countries named in various black-lists inevitably face bilateral pressure from bigger countries. Another important point is to note that offshore activities are recently evolving more around flexible legal entities, such as special purpose vehicles, variety of trusts, etc. If Botswana would like to offer similar services, it may need to visit its main body of corporate law to allow the desired flexibility.

3.51 **There will also be domestic considerations related to off-shoring of domestic business to obtain favourable tax rates.** These complications would be quite demanding of the time and attention of the key policy and decision makers in any country that ventures in offering favourable tax rates to foreigners by way of a segregated tax regime. Given the fact that it is very difficult for Botswana to stay competitive in this field without tax incentives, policy makers should be prepared for the concerns of the international community. A key enabling factor for financial services exports is the number of double-taxation agreements. Botswana has only ten such agreements, compared to 40 in Mauritius.

3.52 **A necessary condition for an international financial centre is to have a modern and well respected regulatory framework.** In order to support IFSC's efforts, the legal framework regarding data privacy and protection, intellectual property rights and enhancing of anti-money laundering regime should be brought up-to-date and satisfy both business needs and international community's interests. Botswana's current financial system regulation is not adequate to facilitate further development. The system has already been experiencing some strains as the financial system evolved, and the study team was told that one international bank decided to locate in Johannesburg over Botswana because of regulatory uncertainty.

3.53 **The background study on the financial sector prepared for this report concluded that the regulatory system has so far been in a rather reactionary posture to new developments in the sector by trying to accommodate new needs within the existing structure.** For example, development of collective investment schemes prompted the need for a new legislation which assigned regulatory oversight to the Bank of Botswana. Similarly, the regulatory powers over the Botswana Stock Exchange are retained by the Ministry of Finance and Development and Planning and the Registrar of Insurance and Pension Funds is also designated as the Registrar of the Stock Exchange. While some of the emerging needs have been tried to be met within the existing institutional structure there is a set of financial activities that are not regulated at all. Asset management companies and small and micro-lenders are among the most significant activities that are not regulated. Presence of important system-wide risks[19] makes a risk based regulatory approach highly relevant in Botswana. NDP9 includes a policy commitment to establish a new regulatory structure for non-bank financial service providers, including those that are currently unregulated, as well as those that are presently regulated by the MFDP (stock exchange, insurance, pension funds). In pursuit of this objective, a feasibility study is currently being carried out for Government by the First Initiative on the establishment of such a regulatory body.

3.54 **One potential criticism arises from having dual tax regime.** Marketing an offshore jurisdiction based on a two-tiered tax regime (i.e., one for domestic economy and another for offshore) is becoming increasingly difficult. Many low and zero-tax offshore jurisdictions can be found to be engaged in harmful tax practices. As a matter of fact, OECD routinely names these jurisdictions. It is also not unusual for many countries to abolish existing tax treaties once the country feels that it is losing too much of tax revenue. For example, Mauritius has successfully utilized its special tax treaty with India and built a relatively large volume of offshore companies. However, India has recently pulled out of this treaty when it felt that it is costing too much for India. Similarly, some Caribbean countries lost special tax advantages for offshore insurance business when the US disallowed such tax advantages.

[19] Such system-wide risks include the dependence of financial sector and pension fund profitability on relatively high interest rates on BOBCs, the scale of real estate investments and lack of depth in secondary markets for securities, and the high level of HIV infection. High level of HIV infection rates also forced banks to require consumers to purchase insurance products for the duration of loans.

RECOMMENDATIONS - The Financial Services Export Sector

- Government to consider broadening IFSC incentives by making all cross-border service exporters eligible for incentives and renaming the IFSC (International Financial Services Center) the ISC (International Services Center) (paragraph 3.48).
- Government to increase efforts to negotiate double taxation agreements (paragraph 3.51).
- Government to expedite a complete overhaul of the regulation of the non-bank financial system, including the offshore jurisdiction. In this regard, a unified non-bank financial system regulator approach, similar to Mauritius and South Africa, could be one possible course to follow (paragraph 3.53).
- Government to make further efforts to streamline the process of obtaining IFSC tax and regulatory approval and reducing the number of bodies involved (currently the IFSC, the MFDP and the Bank of Botswana), possibly through introducing a one-step approval process (paragraph 3.46).

3.55 **Another key issue concerns the anti-money laundering regime**. Botswana is participating within the ESAMLG (Eastern and Southern Africa Anti-Money Laundering Group). Significant amount of assistance is also available in this field from various international organizations, as well as from large industrialized countries.

The Textiles and Apparel Sector

3.56 **The textile and apparel industry in Botswana is an important contributor to economic activity in the country.** It employs over 8,500 workers and generated export sales of over P300 million in 2003. Employment in this sector is likely to grow to over 10,000 workers in 2005 as current expansion plans and new investments come on stream. This compares with total employment in manufacturing of approximately 24,000 workers.

3.57 **Botswana's apparel industry is relatively diverse.** Compared to countries like Swaziland and Lesotho, it demonstrates a range of product that belies its size. Besides the towels produced under the textile sub sector, the apparel sector produces woven garments and denim jeans, knitted commodity type garments such as T-shirts, fully fashioned sweaters, protective garments such as overalls, haute-couture, and ladies underwear including brassieres. At present there are no companies spinning yarn in Botswana. All other raw materials including threads, labels and packaging materials are sourced from outside Botswana.

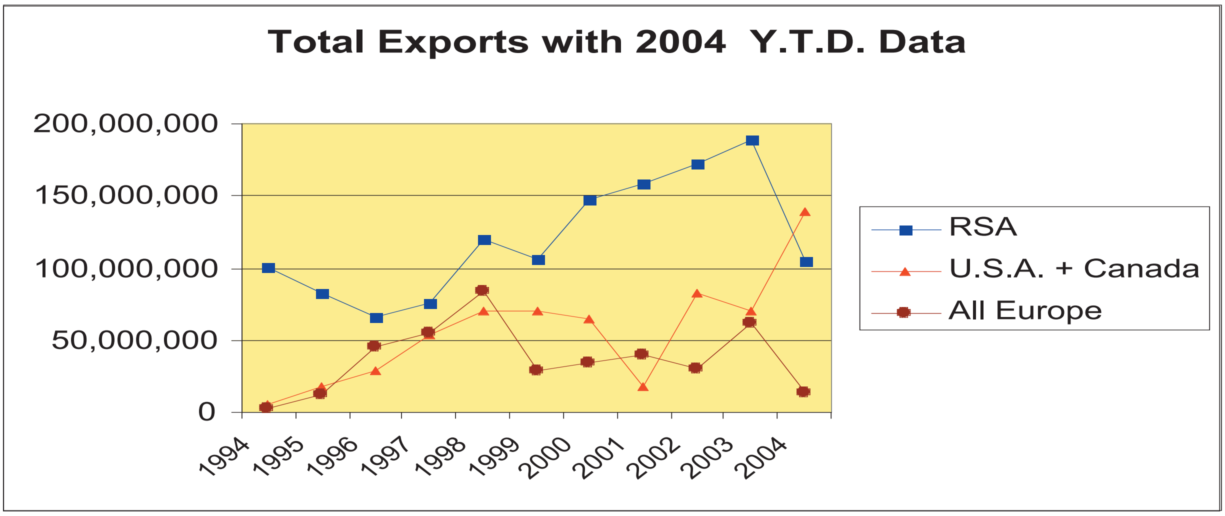
3.58 **South Africa has traditionally been the strongest market for Botswana textiles and apparel.** Eleven factories out of 21 currently operating in Botswana export to South Africa, exporting across all categories including towels, ladies lingerie, protective wear, jeans, woven trousers and T-shirts. The market has grown consistently over the years from P100 million in 1994 to P180 million in 2003. Indicative year to date figures for 2004 show a marked decrease in exports to South Africa. This is a worrying trend and is probably due to the difficulties experienced in South Africa by its own manufacturing facilities. The strong Rand and the lowering of tariffs has led to a flood of cheap clothing into this market and this, coupled with apparel smuggling and dumping has seriously affected the ability of South African firms to compete and Botswana's penetration of this market. One of the new start-ups in Botswana is specifically targeting the South Africa market and this could reverse this negative trend.

3.59 **The SADC market excluding South Africa** has played a significant role in the importation of Botswana's textiles and apparel throughout the 1990's but this market now represents almost no exports.

3.60 **The European market has been growing for Botswana exporters since 1994.** It peaked at P83 million in 1998, declined sharply and has started to grow steadily once again. The 2004 year to date figures indicate a significant drop in exports to this region but this may be due to the fact that the majority of exports to this region are knit to shape jerseys which are subject to seasonal demand and their export would mostly be reflected in the second half of the year. Exporters of knit to shape sweaters indicate high interest from Europe for their products and this market could continue to grow steadily.

3.61 **Exports to the United States have been growing rapidly.** Since Botswana was granted LDC status and the special trade preference that this implies under AGOA there has been a steady increase in exports to the USA. This 'AGOA effect' is particularly marked in 2004 where year to date export figures from the Central Statistics Office showed USA exports exceeding RSA exports for the first time. The CSO qualifies these figures since at the time of writing they were not finalised. Following the ending of the FAP, by 2001 exports to the USA dropped to their lowest level in six years. However, in 2002 these increased dramatically following the AGOA II legislation. Currently 13 of the 21 companies interviewed are exporting some or all of their produce to the USA. This covers the full range of Botswana textile and apparel produce. There is strong potential for Botswana to increase sustainable exports to the USA market particularly if it attracts investment that manufactures knitted fabric for cutting and assembly into T-shirts, polo shirts, sweat shirts, and track suits.

Figure 3-2: Textiles Exports including 2004 Year to Date Data



Source: Central Statistics Office

3.62 **There are a number of challenges for the textile and apparel industry – notably the phase-out of the multi-fibre agreement, the possible ending of special access to the US market, and the ending of FAP subsidies.** It is clear that if the industry is to thrive it needs to rapidly increase productivity and to develop niche markets. There is a clear role for BEDIA in helping the industry to actively target investors that can provide the backward linkages in terms of fabric production which would guarantee preferential access of Botswana apparel products beyond the period of the AGOA LDC special preference.

3.63 **Government has made extensive use of subsidies and other tax incentives to develop the textiles industry.** The main subsidy – the FAP – has ceased and subsidy payments will end in 2005. There are rumours that at least one manufacturer is planning to leave Botswana once their FAP eligibility expires; however, a number of manufacturers interviewed for this study, whose FAP eligibility will expire soon, were emphatic in their intention to stay.

3.64 **Most regulatory and policy constraints to growth in the textiles and apparel industry are economy-wide**, including the burden of bureaucracy involved with establishing a business in Botswana (particularly in relation to the granting of manufacturing licenses), a lack of skilled workers, and delays in getting work permits. Most companies, when questioned about the environment for conducting business in Botswana prioritised problems with getting work permits for their expatriate staff. This is particularly important since highly technological apparel production requires specific skills.

3.65 **The background study on textiles produced for this report found productivity levels to be very low, with the best examples estimated to be 50 percent of established international standards.** The underlying reasons for these poor levels of performance are inadequately trained operators and a lack of control by supervisory management resulting in targets of output and quality not being met. None of the 21 companies interviewed was aware of any training provision available in Botswana specifically aimed at the needs of the garment manufacturing and textile industries.

3.66 **The extremely high rates of HIV and AIDS infection in the country are likely to be strongly reflected in the labour force within this sub sector.** The industry mainly employs women of a sexually active age, some of whom migrate to the industrial areas to take on work. The consultants for the background study found very little in the way of education or mitigation training taking place in any of the factories visited, despite the threat to the labour force. Apparel industries, in particular, provide an important point of leverage

3.67 for education concerning HIV and AIDS and for condom distribution; hence, in-company interventions should be developed as part of the national AIDS strategy.

3.68 **Most textile and apparel industrialists are not members of a representative association.** There is no collective voice for the textile and apparel industry when, for example, crucial trade negotiations impacting on access to important export markets is underway. Government should be in a position to actively engage with this important sector of its manufacturing portfolio but, to do this, it needs an organised partner.

RECOMMENDATIONS - The Textiles and Apparel Sector

- BEDIA could hold a consultation meeting with the manufacturers who are currently receiving subsidies under FAP to find out what barriers to competitiveness each faces. BEDIA needs to make sure that these barriers, some of which are discussed in this report, are overcome as far as possible (paragraph 3.62).

- In-company interventions to be developed as part of the national AIDS strategy (paragraph 3.66).

- BEDIA could develop a comprehensive response to the lack of productivity in the textile and apparel industry. It should commission productivity audits and training needs analysis, identify suitable service providers to address the needs of the industry both nationally and regionally, identify means of financing productivity enhancement and training and develop the market for training service providers to the industry (paragraph 3.65).

- Industrialists in this sector should be encouraged and assisted to form an industrial association to lobby and negotiate for their specific needs. BEDIA could use its offices to facilitate the establishment of an association of Botswana Textile and Apparel Manufacturers that is constituted as an independent, officially registered body. This association would then become the key point of contact with the industry and would represent its interests in discussions with Government and Labour Unions, and could participate in the preparations for trade negotiations (paragraph 3.68).

The Automotive Products Sector

3.69 **This sub-sector actually constituted the second major commodity in the merchandise export basket between 1996 and 98, but then declined since 2000 following the closure of Hyundai assembly plant.** The sector broadly defined as the 'automotive sector' refers to manufacture (assembling) of vehicles, accessories and parts (CSO, 2001). Its share of exports fell from over ten percent in 1998 to 2.78 percent in 2002. Further, a considerable proportion of current exports represent stock and imported vehicles, accessories and parts to other SADC countries. Production or assembling activities exist only for a few products: tractors, motor vehicles for the transport of ten or more people, parts and accessories for motor vehicles and cars.[20]

Table 3-2: Motor Vehicle Exports by Type of Vehicle (in pula)

HS Code	Description	Destination	1998	1999	2000	2001
8701	Tractors	RSA	99,973,936	46,865,332	127,485,058	158,171,599
		Zimbabwe	2,948,441	6,272,127	109,721	219,879
		Namibia	405,602	554,548	1,857,578	-
		Zambia	1,500,589	6,134,071	87,055	89,952
		ROW	9,355,167	13,124,243	576,080	368,485
		TOTAL	**114,183,735**	**72,950,320**	**130,115,491**	**158,849,915**
8702	Motor vehicles for the transport of ten or more persons, including the driver.	RSA	6,879,920	7,414,623	9,678,398	15,654,125
		Zimbabwe	5,567,372	24,563	74,552	3,267,660
		Namibia	744,921	381,476	-	-
		Zambia	3,392,499	1,561,952	694,773	2,411,213
		ROW	26,292,642	23,900,511	9,229,087	9,033,265
		TOTAL	**42,877,354**	**33,283,125**	**19,676,810**	**30,366,262**

[20] Information supplied by Industrial Affairs Department, Gaborone, Botswana.

HS Code	Description	Destination	1998	1999	2000	2001
8708	Parts and accessories of the motor vehicles of headings 87.01 to 87.05	RSA Zimbabwe Namibia Zambia ROW **TOTAL**	4,016,024 258,502 32,316 30,326 42,128 **4,379,295**	3,337,634 148,055 3,052 26,357 14,705 **3,529,802**	4,054,985 230,791 749 1,213,229 64,652 **5,564,406**	4,561,470 461,251 681 39,905 38,481 **5,101,788**

Source: CSO

3.70 **This study conducted a small firm-level survey of the 5 firms engaged in this sector.** This constitutes all of the exporting firms with the exception of one firm that did not participate in the survey. The total employment was 995 workers. The leading firm in the sector is wiring harness manufacturing company, which alone employs 690 workers, working under the technical management of DELPHI International. Total exports from all firms for the year 2003 are P500 million, spread mainly between Europe and South Africa. The average age of the firms is eight years; two have been producing for the last ten years, and two for eight and one five years. Three out of the five firms are in a very niche market. Leaf springs and batteries are supplied to agents with links to large workshops rather than assemblers, and therefore cater to the replacement demand. Similarly, the reconditioned tractor exporter targets the middle income farmers who cannot afford to buy a new tractor.

Table 3-3: Firm Survey: Characteristics

No. Firm	Ownership type	Share of the foreign partner	Product type	Employment (as in 2003)	Age of the firm (in years)	Export destinations
1	Joint venture\ majority foreign controlled	60	Leaf springs	85	5	SACU area
2	Joint venture \ equal status	50	Car batteries	75	10	SACU/rest of Africa
3	Fully foreign owned	100	Reconditioned tractors	45	8	Rest of Africa
4	Fully foreign owned	100	Assembling of Trucks and buses	100	10	SACU
5	Joint Venture	50	Electrical Harnesses for automobiles	690	8	Europe

Source: BIDPA

3.71 **The firms benefit substantially from government incentives.** Of the five firms, three firms had the benefit of FAP assistance; although they ostensibly came to Botswana not being attracted by the FAP. Out of the five firms, two use the South African MIDP (Motor Industries Development Programme, which applies to all SACU producers): They import original components from Europe and export outside SACU, which qualifies them to meet the requirements of benefiting from the MIDP; their share of output constitute around 75 percent of the total output reported by the surveyed firms.

3.72 **Following the closure of the large Hyundai assembly plant in Botswana, a fledgling auto-sector remains. This sector evolved through generous FAP incentives, the MIDP program and high tariff protection in the SACU market.** Of the five firms surveyed for this report, three benefit from (soon to be phased out) FAP subsidies, two (the majority by output) benefit from MIDP. Further, sales to the tariff-protected SACU market account for about one-quarter of employment of the firms surveyed.

3.73 **The remaining automotive products companies, therefore, face a challenging future.** The MIDP scheme is potentially open to WTO challenge as an export subsidy (see Box 3-2). The tariff for light motor vehicles and parts was above 40 percent in the late nineties, and it is still high at 36 percent. However, the phase-down schedule will see tariffs falling to 28 percent by 2009.

3.74 **The background auto-sector study for this report did not report any sector-specific policy constraints to exports.** Instead, exporters reported on a common set of challenges, including human capital, transport costs, utility costs, delays in getting work permits, and the recent appreciation of the Pula against the US dollar and the euro.

Box 3-2: Does Botswana Benefit from Vehicles Protection and the MIDP?

- The Motor Industry Development Programme (MIDP) initiated by the South African Department of Industry, through SACU, is the major driving force in supporting more vehicle assembly operations and manufacturing for the export of automobile components and parts in the SACU area. The MIDP provides a large reduction in import duties on completely built up units for exporting companies, and has been a facilitating factor in choosing South Africa as an assembling centre by western and Japanese automobile giants. A second review of the MIDP extended it to 2012. However, it is potentially open to WTO challenge as an export subsidy. The rapid growth and development of automotive industry in South Africa has also been due to the high level of tariff protection. The tariff for light motor vehicles and parts was above 40 percent in the late 1990s. It currently stands at 36 percent with a phase-down schedule for it to fall to 28 percent by 2009 (see below).

Table 3-4: Phase down in the rate of customs duty on imported light motor vehicles

Date	Light motor vehicle (Duty as percentage of ad valorem)	Components (Duty as percentage of ad valorem)
2003	38	29
2004	36	28
2005	34	27
2006	32	26
2007	30	25
2008	29	24
2009	28	23

Source: International Trade Administration Commission of South Africa

- However, while this regime may be of temporary benefit to Botswana's fledgling automotive products industry, it imposes high costs on the rest of the economy. Further, it adds to the cost of transportation for Botswana's exporting firms. As a one-off capital import, producers are not allowed to claim duties on vehicle imports as an allowable expense under the duty-drawback general rebate schemes for exporters. Duty rates on cars, light goods, vehicles and minibuses are still at the high level of 38 percent as at 2003, while the rate of duty on original motor parts is 29 percent. Under the terms of the MIDP, international companies that both import and export motor vehicles and parts are able to use export credits to reduce import duties. The effective rates of protection on exports range from 30 to 40 percent for South African vehicle manufacturers, and from 26 to 30 percent for component manufacturers in South Africa (Flatters, 2002). This means that, while South African motor companies and a few component manufacturers in Botswana benefit, Botswana exporters and consumers pay more for vehicles. The FIAS (2004) survey showed that transportation costs for imports and exports were a major obstacle for approximately 50 percent of respondents.

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IMPORT TARIFF AND EXEMPTION SCHEMES FOR EXPORTERS

Customs Duties Rebates

3.75 **The Customs and Excise Duty Act and the Value Added Tax (VAT) Act exempt payment of certain customs and excise duties, as well as VAT, on raw materials imported by registered manufacturers.** These schemes are covered by SACU rules, and until recently were determined by South Africa with little consultation or predictability with respect to changes to the rules. These schemes function effectively with few unnecessary delays imposed on importers using the schemes.

- **General Rebates:** this is the most heavily used rebate scheme. Raw materials not exempted under the Industrial Rebates Concession – when imported for manufacturing for export outside of the SACU area – may be exempted under the General Rebates of Duty Concession. Raw materials covered under the General Rebates of Duty Concession are also exempt from VAT. The provision for rebates of customs duty extends to raw materials that are not available locally. The rebate concession is withdrawn once raw materials become available locally, even if this is at a higher price. Equipment imported on a *temporary* basis for specific projects is duty exempt.

- **Industrial Rebates:** after general rebates, this is the next most heavily used scheme. The Industrial Rebate Concession exempts from payment of customs duties some raw materials for products sold in the domestic market or exported. Industrial rebates are only available to targeted industries that the Government would like to stimulate, such as the textiles, prepared foodstuff and beverage industries. However, goods manufactured for the domestic market attract VAT upon their sale to the market. This type of incentive is considered by many tax experts to be ineffective when used for domestic production, since under competitive circumstances it simply reduces the cost of the final product for domestic producers without changing the profitability of those enterprises involved.

- **Customs Duty Drawback:** under the Customs Duty Drawback Facility, exporters may claim a refund on any customs duties that they paid on imported materials used for producing export products. Within six months of exporting, exporters may claim an equivalent amount to what they paid as customs duties. VAT is also refundable, provided the exporter has registered with the VAT authority.

- **Duty Credit Certificate (DCC) Facility:** the DCC Facility is product-specific and is applicable to the textiles and clothing industry. Under the DCC Facility, rebates of customs duty are extended to companies that have been exporting outside the Southern African Customs Union (SACU) for at least a year. The Department of Customs and Excise reports that the scheme is currently used by only a few companies, since other exemption schemes are more popular.

- **Importers of machinery used for exports can claim repayment of VAT under 'schedule 4'.** Most machinery imports are already zero-rated for tariff purposes.

3.76 **The definition of imported inputs that are allowable for exemption is defined fairly narrowly to include only those inputs directly used in the production process.** For example, tariffs paid on the purchase of energy, or petrol used in the transportation of the exports, would not be duty-exempt. Further, domestic manufacturers who produce goods and services used by exporters (known as "indirect exporters") are not eligible for duty drawback on the tariffs they pay for imported inputs. Korea, Taiwan, Mexico and Kenya all gave duty exemption to such manufacturers. It is extremely difficult to calculate the refunds due – Taiwan used a complicated input-output coefficient for each line of production, Kenya used a single fixed coefficient for all goods, although it had to subsequently change this system because of inequities in payment. An additional cost is placed on exporters because anti-dumping tariffs are not eligible for duty exemptions and rebate schemes (see Box 4-3).

3.77 **Value-Added Tax is not payable on raw materials for exporters.** Firms registered with the Director of VAT may claim VAT charged on inputs used in production, based on a formula prescribed in the VAT Act. In addition, like all SACU countries, Botswana exports attract VAT at a zero rate.

3.78 **VAT and duty-drawback and exemption schemes are a second-best solution.** The optimal policy for the exporters is to eliminate tariff and non-tariff barriers on inputs altogether. Transaction costs of such schemes are not negligible. Countries such as Canada, Bolivia, Korea and Thailand, experienced a heavy volume of fraudulent claims for refunds of input VAT payments in the years following the introduction of their VAT systems (Jenkins and Kuo, 2002). More preferable for Botswana would be lower import tariffs on imported materials used for export. This would remove the need for the bureaucratic machinery necessary to prevent the abuse of concessional treatment for non-export purposes (e.g., complex checking systems in the area of custom duties, taxes and bank credit).

RECOMMENDATIONS - IMPORT TARIFF AND EXEMPTION SCHEMES FOR EXPORTERS

- Botswana should propose with SACU a change in the trade regime to allow anti-dumping tariffs to be eligible for duty exemptions and rebate schemes (Box 4-3).

Government to take follow-up review on whether broadening the definition of inputs that are exempt from customs and VAT would make a significant cost difference to exporters Box 3-3

Box 3-3: Does Botswana need an Export Processing Zone (EPZ)?

NDP 9 included a commitment for the Government to give consideration to establishing Export Processing Zones or some other variant of a free trade zone, as a mechanism for facilitating and stimulating investment in the export sector (NDP 9). In a review of the experience of South Africa, Kenya, Mauritius and Zimbabwe, Helleiner (2002) found that EPZs had only a very limited effect – with the exception of Mauritius – in stimulating non-traditional export growth. EPZs in

Kenya have been characterized by excess capacity (Jenkins and Kuo, 2002). In fact, a well-functioning customs administration and duty-free scheme for exporting companies obviates the practical rationale for a free trade zone.

Re-labelling the current customs regime as an EPZ for marketing purposes is unlikely to have much impact on levels of FDI and exports, unless something new were on offer. As explained above, only raw materials used for export are exempt from customs duty and VAT in Botswana. Capital goods and some business inputs are not exempt. Although most machinery and capital goods have zero tariffs, some key inputs still face tariffs and VAT (for example, an MFN steel tariff of 5 percent, vehicle tariffs of 38 percent (see Box 3-2), furniture tariffs of approximately 20 percent, transport equipment tariffs of approximately 12 percent, and printing and publishing tariffs of approximately 7 percent). South Africa is in the process of establishing Industrial Development Zones (IDZs), in which capital equipment will be exempt from customs duty and VAT. The relevant legislation will also be available for other SACU countries.[21] The Namibian EPZ also exempts capital goods and equipment. A key policy question is whether broadening the definition of inputs that are exempt from customs and VAT would make a significant cost difference to exporters – this needs to be explored further.

EXPORT PROMOTION AND PRIVATE SECTOR SUPPORT INSTITUTIONS

3.79 **Through BEDIA, BDC, IFSC, MTI and other support institutions, Botswana has a broad range of export promotional activities.** Such institutions are essential if Botswana companies are to develop products of sufficient quality for export, and then to market them. Government is building up the capacity of BEDIA and other organisations to provide sufficient advisory services to help exporters in developing their company plans, sourcing needed imported inputs, identifying and using appropriate export services, and dealing with trade-related procedures, documentation, payments and financing facilities. NDP9 rightly identifies the private sector as the primary provider of such business services in the medium term.

3.80 **The Government encourages the private sector to be active in the policymaking process.** The Government established the High Level Consultative Council (HLCC), chaired by His Excellency the President of the Republic of Botswana, which provides another forum for Government and the private sector to discuss issues of mutual interest and concern. Sectoral HLCCs also meet regularly (BEDIA, 2003b). There are several other forums where PPP consultations take place, including NEMIC, the National Business Conference, the Smart Partnership meetings, the BOB Economic Briefings, etc.

3.81 **There are a number of public and private bodies supporting exporting companies**:

- **Botswana Export Development and Investment Authority (BEDIA):** BEDIA operates an Investors Services Centre (a "One Stop Shop"), which assists investors to obtain pre-investment support services such as land, buildings, work and residence permits, licences and any other permit of clearance they may require. Its niche focus products are textiles, jewellery, leather products, glass and IT. BEDIA organises

[21] The Namibian Export Processing Zone offers a package of fiscal incentives for local and foreign investors. The incentives are offered to approved EPZ enterprises located anywhere in Namibia, subject to at least 80 percent of the products manufactured being sold outside SACU countries. The eligibility status is that enterprises must engage mainly in manufacturing for export outside SACU and the benefits/incentives are total exemption from corporate income tax, custom duties, sales tax, transfer taxes and stamp duties, which are for an unlimited duration for both foreign and local firms.

export missions and attends trade fairs to advertise Botswana products. Its mandate also calls for BEDIA to identify and research new markets to facilitate targeted export promotion. As part of a new strategy, BEDIA is refocusing its activities on export development, in contrast to export promotion, based on a perception that weak internal capacity for product development is the major constraint to exporting from Botswana. In this context, BEDIA is preparing an export development programme as part of JITAP II, which has identified apparel, handicrafts, leather and leather products, agriculture and agriculture products (mainly beef) as sectors for further exploration and training. This will include working with the authorities to develop investor targeting strategies.

- **Botswana Confederation of Commerce, Industry and Manpower (BOCCIM):** BOCCIM is the private sector organisation that is recognised by the Government as representing the interests of the private sector. BOCCIM represents the private sector at the HLCC. BOCCIM sponsors an extensive programme of training courses and provides its members with ongoing assistance with industrial relations matters, staff training, seminars and workshops.

- **Exporters Association of Botswana (EAOB):** this is a non-governmental trade organisation covering both manufactured goods and services. EAOB endeavours to increase production of export related products by providing specialised export services to existing and potential exporters, by identifying foreign markets for locally produced exportable merchandise and by making representation to the Government on behalf of the export community.

- **Enterprise Botswana:** this was established to advance and support entrepreneurship development through programmes to stimulate business creation and promote the growth of existing enterprises. Local entrepreneurship is encouraged by selecting promising small and medium sized enterprises and helping them to expand. It also links larger companies with small ones and gives entrepreneurship training management seminars.

- **Botswana Bureau of Standards (BOBS):** BOBS was formed primarily to formulate a local set of standards and to coordinate quality assurance activities. It carries out training in quality management systems and auditing. The Bureau is establishing a system to offer certification through three schemes: Product Certification, Quality Management Systems; Certification and Environment Management Systems; and Certification. Under the Product Certification scheme, suppliers will be able to mark their products that conform to a Botswana standard with a BOBS quality mark, Quality Management System Certification.

- **Venture Capital Fund:** a P200 million Venture Capital Fund (VCF) was launched in the latter part of 2003, managed by CEDA. This Fund is targeted at providing risk capital by way of equity and/or quasi-equity and other investment instruments to private citizen owned or joint-venture companies. These companies can either be new or existing business enterprises in Botswana. The Venture Capital Fund is not a permanent investor into a company. It will seek to exit from the investee company, that is to say, to sell or realise its investment, over a 3 to 7 year period.

RECOMMENDATIONS - EXPORT PROMOTION AND PRIVATE SECTOR SUPPORT INSTITUTIONS

- BEDIA and BDC to appraise whether they should continue in the provision of factory shells (paragraph 3.82).
- BEDIA to coordinate JITAP implementation to build on work undertaken in this study (paragraph 3.81).

3.82 **Both BEDIA and the Botswana Development Corporation (BDC) - a development finance parastatal - develop various facilities for industrial and commercial lease for suppliers to the domestic market or exporters; these facilities are provided at market rates.** This was in response to the difficulties investors were having in securing business accommodation in the 1990s. With increased private suppliers of factory shells and office accommodation now in operation in Botswana, this role for parastatals to play may have become redundant.

TRADE FINANCE AND EXPORT CREDIT INSURANCE

3.83 **There are mixed views concerning whether there is sufficient provision of trade finance and export credit insurance.** The Situational Analysis to Assist in the Development of a National Export Strategy (BIDPA, 2004e), the FIAS (2004) study, the UNCTAD (2003) Investment Climate Review and the World Bank (2004) Doing Business report provide some information suggesting trade finance and export credit insurance is not a problem. However, private sector stakeholders, especially from small and medium scale enterprises, argue strongly that they do suffer from a lack of trade finance. In particular, smaller export enterprises have reported having difficulties gaining access to trade credit in a timely fashion. Exporters typically use advance payment from Zimbabwe, letters of credit (L/Cs) for customers in Zambia, the EU and USA, and Botswana Export Credit Insurance (BECI) for customers in South Africa. Of note, sales to chain stores in South Africa are often on 30, 90 or even 120 day credit terms, implying a significant credit cost to exporters (FIAS, 2004). FIAS (2004) made suggestions on minor adjustments to the system that would facilitate a more rapid payment of exporters.

3.84 **Unlike South Africa and a number of other SADC countries, Botswana does not offer state-funded marketing support for exporters, or a trade finance or credit scheme. However, it does offer an export insurance scheme.** Botswana Export Credit Insurance and Guarantee Company Limited (BECI): this Government-supported company provides short term export credit insurance for exporters, covering exports from the date of shipment for transactions where credit terms do not exceed 180 days. Exporters have the choice of three cover schemes, namely Post-Shipment Cover, Export Finance Guarantee Scheme and Domestic Cover. BECI is reportedly facing a low-uptake and demand for its services. BECI is currently in discussions with Government on whether incentives should be developed to guarantee import and export finance as part of the National Export Strategy Development. This would essentially be a guarantee scheme, whereby BECI would guarantee commercial and development banks on their short term advances to exporters and importers. BECI would, in turn, be reinsured by Botswana Government on its exposure to the banks. This proposal requires careful consideration before taking steps to create another public sector financial institution.

3.85 **The Ministry of Trade and Industry provides political risk reinsurance.** But MTI's services are viewed as inadequate and inefficient by stakeholders (BIDPA, 2004e). The overall quality of service is considered poor. Repeated complaints were lodged over the past year relating to MTI's failure to respond to correspondence and to provide satisfactory responses. BECI suggests that the underlying reasons for the ineffectiveness of MTI may be a shortage of qualified staff, poor organisation of human resources and the lack of proper delegation of authority.

RECOMMENDATIONS - TRADE FINANCE AND EXPORT CREDIT INSURANCE

- Conduct a performance audit of the provision of political risk insurance by MTI, including an assessment of need (paragraph 3.85).

LICENSING RULES AND STANDARDS

National Non-Tariff Measures Directly Affecting Exports

3.86 **There are relatively few restrictions on exports in Botswana.** With the exception of diamonds and beef, Botswana allows exports to go largely unhindered by unnecessary restrictions. Given its size, Botswana is a price taker for all its exports, with the exception of diamonds, where Botswana operates as part of the De Beers marketing structure.

3.87 **All commercial exports require an Export Declaration Form.** Government restrictions apply to the export of rough diamonds. Botswana imposes export prohibitions on the export of livestock, a measure ostensibly driven by concerns for maintaining a good track record on meeting EU SPS requirements. The National Licensing Authority mainly deals with the registration and licensing of business enterprises in the various sectors of the economy, which have been licensed in accordance with the Botswana Companies Act. The Local Procurement Unit in the Department of Industrial Affairs within the Ministry of Trade and Industry is responsible for the enforcement of local content requirements. Where health attestation requirements are stipulated by the export destination country, the Department of Animal Health issues an export certificate on the basis of importing country's health and safety requirements.

Table 3-5: Prohibitions/Restrictions on Exportable Products

Inventory Category	Article and description by HS Code and if applicable corresponding legislation or regulation	Justification/Rationale for the Prohibition/Restriction	Date of Inception	Expiry
Part V J[22]	HS 01.02: Live Bovine Animals; Cattle Export Tax Act.	Revenue raising device; rarely if ever used since BMC was given an export monopoly over beef in 1967	Pre 1967	Still in the Laws of Botswana
Part I E	HS 71.02: Diamonds, whether or not worked, but not mounted or set. Contained in commercial	With Debswana as the sole current producer of raw diamonds and with Government as a 50:50 partner in Debswana and with a 15 percent holding in	Circa 1971 when production started at	Still in force

	agreements between Debswana, De Beers and the DTC.	De Beers and two seats on the main De Beers Board, such single channel marketing to the Diamond Trading Company has made sense in the past.	Orapa	
Part IV B	HS 04.01: Milk & cream, not concentrated Control of Livestock Industry Act, 1941	Milk or cream could not be exported without a permit. This apparently served both an SPS function and possibly as a source of revenue, but it has not been used since the middle 1960s.	1941	Still in the Laws of Botswana, but has not been used in years.

Source: SADC Non-Tariff Barriers Synthesis Final Draft Review (Imani, 2004)

Standards

3.88 **There has been a rapid increase in the number of approved standards – from 30 to 167 between 1998-2002.** The Botswana Bureau of Standards (BOBS) formulates and implements technical standards as per the Standards Act of 1995. In order to execute its mandate, BOBS develops a regulatory framework based on the policies applicable to various Government departments, e.g., the Department of Animal Health and Production for animal and animal products, and the Department of Crop Production and Forestry for fruits and vegetables. BOBS also acts as an enquiry point for all matters relating to standards. Botswana recognizes foreign results and standards, and uses foreign accredited laboratories to conduct testing not available domestically. It is collaborating with SADC countries to develop a regional body for accreditation of conformity assessment facilities, which would allow mutual recognition among all members. Botswana has accepted the Code of Good Practice for the Preparation, Adoption and Application of Standards contained in Annex 3 of the WTO TBT Agreement.[23]

3.89 **Despite its major role as a standard setting institution, BOBS experiences the following problems**:

- The Standard Certification Scheme that applies to traders involves a cost (i.e., an application fee and the inspection process). This has negatively affected uptake, particularly by very small traders, who consider the costs significant.
- The certification process requires testing facilities. BOBS does not have adequate testing facilities yet and has to rely on private laboratories to test products. However, there is no accredited laboratory yet in Botswana. For products requiring accredited laboratory testing, BOBS has to seek these services outside the country. This causes delays in the supply of exports, which could have negative impacts on exports.
- BOBS is not able to implement border controls to monitor the quality of trans-border goods because of the absence of a holding facility. This has implications on the monitoring of quality of imports, including inputs used for manufacture of exports.
- Development of product specifications requires that legislation of departments linked with BOBS should be harmonised. This is yet to be achieved.

3.90 **Under Article 28 of the new SACU agreement, Botswana and other members have agreed that "Member States shall strive to harmonize product standards and technical regulations within the Common Customs Area".** A priority for the new SACU

[23] WTO document G/TBT/CS/N/109, 31 August 1999.

Secretariat will be to give some clarity and a roadmap on how Members could achieve this goal. Continued cooperation with the South African Bureau of Standards should be encouraged. Most of Botswana's non-traditional exports are likely to go to the region. South Africa, which dominates exports from the region to the rest of the world, will generally set the standards that will apply in the region, and for South Africa to be globally successful, it will need to conform to international standards. For specialty exports from Botswana, there may be special standards that Botswana will need to satisfy; and BOBS may be able to help with establishing those Botswana firms that can meet those standards. However, it will probably be a relatively small number of such special cases. Therefore, BOBS should remain limited in size and not duplicate work that could be done elsewhere.

3.91 **Another vehicle for regional harmonization is within SADC, although this represents a more diverse set of countries.** SADC has helped to establish a structure for regional cooperation. The SADC Protocol on Standards, Quality Assurance, and Metrology went into effect in 2000, although some elements had previously been established. The protocol's goal is to eliminate technical barriers to trade, both within SADC and between the region and the outside world. Mechanisms for cooperation among governments in the development of standards and product accreditation were established. It also coordinates metrology training for government officials at the National Metrology Laboratory in Pretoria.

3.92 **Efforts by concerned consumers and international labour organisations have focused attention on the working and environmental conditions under which products are manufactured.** This has a particular impact on the textiles and apparel sector. This attention and the possibility of negative publicity have forced all the international brands to adopt Codes of Conduct to which factories must comply while producing their products. These Codes of Conduct are driving the transformation of the garment sector globally and are effecting working conditions in Botswana. All factories producing for export to the USA have to comply with minimum standards; and they are inspected regularly to ensure their compliance. Codes of Conduct ensure that the Botswana apparel sector keeps pace with changes in industrial relations policies and also ensure environmental best practice is adhered to in this sector.

Measures affecting Imports

3.93 This section reviews health and safety, licensing and other controls necessary for the clearance of imports and exports.

Table 3-6: Botswana: Prohibitions/Restrictions on Imported Products

Category Inventory	Article and Description by HS Code and if Applicable Corresponding Legislation Or Regulation	Justification/Rationale for the Prohibition / Restriction	Date of Inception	Expiry
Part II A	HS 0207.14.90: Meat of Fowls, meat or offal, frozen, other; most recent SI No. 54 of 2003 in terms of the Customs and Excise Duty Act	Virtual anti-dumping move for the rest of the non-SADC world	2002	na
Part V H	HS 0805.10: Oranges and products thereof. Import permits in terms of the Control of Goods, Prices and Other Charges Act (CGPOC Act)	To stabilise internal market conditions during seasonal gluts in supply at harvest time (same time as most of the crop in SA)	Annually since late 1970s	3 months after harvest period
Part V H	HS 0407.10: Bird's eggs in shell, fresh, preserved or cooked, CGPOC Act	To stabilise internal market conditions during times of over supply	As needed since early 1990s	When market returns to "normal"

Category Inventory	Article and Description by HS Code and if Applicable Corresponding Legislation Or Regulation	Justification/Rationale for the Prohibition / Restriction	Date of Inception	Expiry
Part II A	HS 0207.14.90: See first item above CGPOC Act		As needed since early 1990s	When market returns to "normal"
Part II A	HS 1905.90: Bread….Other , CGPOC Act	With the entry of large SA supermarket chains into Botswana with their branded bread loaves, the local bakeries convinced the Minister that they deserved protection.	October, 2003	Still in effect, but cancelled for products not readily produced locally.
Part IV B	HS 0602.90 and 0604.90: Live Plants, etc. other, Plant Diseases and Pests Act, 1959	Control plant diseases	1959	Until replaced by a modern SPS Act
Part V L (Levy)	HS 11.01: Milled wheat or meslin flour, Customs and Excise Act	Unfair competition bordering on dumping resulted in the imposition of a 15 percent levy on top of an import permit system	2003	Still in force
Part II A	HS 10.01: Wheat, 10.05: Maize, 10.07: Grain Sorghum and 12.02: Ground nuts, BAMB Act, 1974	Ensure internal market stability by setting floor prices and in the case of harvest periods, avoiding gluts of imports- done largely through permits or exercise of virtual monopoly power.	1974	Still in force

Source: SADC Non-Tariff Barriers Synthesis Final Draft Review (Imani, 2004)

3.94 **There are a number of issues concerning import licensing**:

- SPS provisions are managed by the Department of Agricultural Research under the Plant Diseases and Pests Act of 1959. **This Act is out of date and a replacement is under review.**

- **Imports of some agricultural products, including dairy products, vegetables, meat and meat products, and poultry must be licensed on food-security grounds.** The Trade Act (2003) awarded powers to licensing committees of local authorities - there are 25 categories of specific licences. For SPS reasons, most imports of agricultural products and plants require approval from the Ministry of Agriculture. For products whose import license is dependent on local supply (e.g., cabbage, spinach, tomatoes, butternuts, oranges), permits may be suspended if local supply is available. The import permit issuing process is manual; as such, importers may experience some delays. The permit issuing process is conducted at the Ministry of Agriculture headquarters and the Regional Agricultural Offices, and not at the border. Importers may incur additional costs in terms of time and transport. At the border, the Department of Customs and Excise conducts verification of import permits and physical examination of goods on behalf the Department of Crop Production and Forestry. These departments are not linked electronically.

- **Other licenses**: import licences are required for boats and aquatic apparatus and second-hand goods (mainly clothes and cars); imports of endangered species covered by the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES) are licensed; for security reasons, imports of firearms and ammunition must also be licensed; permits are required only for a limited number of commodities, and are issued by the appropriate authority, e.g., the Department of Wildlife and National Parks. There are no licensing procedures that are specifically targeted at foreign investors.

- While the application for an import permit from the Ministry of Trade and Industry is a clear process, **the import permit issuing service is only available in Gaborone**. Traders residing outside Gaborone have to incur costs in terms of time and transport to obtain licenses. Also, the Control of Goods Act, which is the main instrument used for issuing import licenses. The range of products has increased; and there is need to review the relevance of import permits for some products.

RECOMMENDATIONS - LICENSING RULES AND STANDARDS

- Undertake a detailed review of all import permits with a view to removing this requirement for all but a limited number of commodities for security, public health and public morality reasons. Government could review the Control of Goods, Services and Other Charges Act, possibly applying a costs and benefits approach to assess whether a reduced scope for the Act is beneficial. This should include an assessment of the scope of allowing issuing of import permits outside of Gaborone (paragraph 3.94).

- Government to develop a 'Standards Strategy', which could include an assessment for the scope for greater harmonisation of standards within SACU – in particular whether it would be feasible to introduce a single set of standards across the region with inspections to be done by a single authority with clear guidelines of why inspections are being done (paragraph 3.89).

- At the border, the Department of Customs and Excise conducts verification of import permits and physical examination of goods on behalf the Department of Crop Production and Forestry. These departments should be linked electronically to avoid delays for importers in clearing goods in the event of queries (paragraph 3.94).

4. TRADE POLICY FOR EXPORT GROWTH

4.1 **Exporters and importers in Botswana face an increasingly complex mix of regional, bilateral and multilateral trading arrangements.** There are a number of market access barriers ranging from tariff restrictions, complex and expensive product standards and safety requirements, and restrictive rules of origin. Factoring in domestic regulations, the incentives this provides to the private sector need to be clearly understood. Following the 2002 SACU Agreement, there is new scope for Botswana to influence trade policy. To help policymakers use this influence effectively in SACU and elsewhere, this chapter seeks to address two fundamental issues. First, what are the priority market access barriers facing Botswana's current and potential exports? Second, to what extent does trade policy create an 'anti-export bias' in Botswana?

MAIN TRADE AGREEMENTS

The Southern African Customs Union (SACU)

4.2 **First established in 1910, the Southern African Customs Union Agreement (SACUA) was renegotiated in 2002 to further integrate member states, reduce distortions and**

ensure a more stable and balanced flow of funds through a revised revenue-sharing formula. SACU comprises South Africa, Botswana, Lesotho, Namibia and Swaziland. It also establishes clearer mechanisms for members to influence SACU policies. SACU harmonizes applied customs tariffs, excise duties, valuation methods, rules of origin and contingency trade remedies (including anti-dumping measures). There are no rules of origin requirements for products sold between SACU members.

4.3 **BLNS members see the revenue-sharing aspects of SACU arrangement as compensation for the trade diversion, price raising and 'industrial polarisation' effects of the SACU 'Common External Tariff' (CET).** SACU member's share of the revenue pool is based on their share of *intra-SACU* (not overall international) imports. Botswana in some cases imports products from South Africa that it would otherwise have been able to source more cheaply from elsewhere and collect the tariff revenue. Estimates of the price-raising effect of this 'trade diversion' vary. In 1992, this was estimated at between 20-30 percent by the Government of Botswana. Of course, the 'polarisation effect' also limited Botswana's ability to mimic the infant-industry protection being adopted, often unsuccessfully in neighbouring countries, thus avoiding expensive restructuring programs at a later date.

Box 4-1: SACU – Towards a Single Market?

- This report advocates deeper economic integration in SACU, based on the concept of "open regionalism" (GEP 2005), where barriers are also reduced between the region and the outside world. This is for the following reasons.
- First, Botswana cannot 'go it alone', given its small population. South Africa is likely to remain the major market for its non-diamond exports because of high transport costs and the trading benefits of proximity. Apart from Egypt, South Africa is the only major market in the region. The record of using import substitution in the region to promote demand for more advanced products is not good, and small countries have had particular difficulties in using such techniques because of their small market size. A small domestic market size is also a major constraint to investment, since it limits the scope for economies of scale and expansion. A survey of French companies found small market size to be the main factor limiting investment in Africa (Charalambides, 2004).
- Second, although Botswana has a higher GDP per capita than South Africa, it can still benefit from South Africa's more developed private sector, market know-how, expertise and investment. South Africa accounts for almost half of the stock of FDI in Botswana. Investors from outside the African continent are so far mainly interested in minerals. Attracting high quality investors who actually understand the international market is a challenge, given that the economy of the entire SACU region is approximately the size of Belgium. Recent surveys of South African investment in Africa indicate that familiarity with and the need to use South Africa as the "anchor" economy are important determinants of investment
4.4 (Charalambides, 2004). In some sectors, for example the textile or automotive products sectors, South Africa offers the potential to link into regional supply chains.
- Third, the harmonization of regulations required to move towards a single market could act as a major spur to increased investment and trade within the SACU region and beyond. It would ultimately remove the need for the control of goods at the border, would encourage inwards investment to the region (since investors would have a common rules platform), and would encourage greater cross-border competition in services. As argued throughout the report, without such cooperation the impact of having a customs union with a common external tariff is limited. The European Union did not have free
4.5 circulation of goods before the single market: *"Despite the absence of customs duties in trade between Member States, in fact there was little difference in administrative burden or appearances between intra – Community trade and trade with non – member countries… Customs clearance at the Community's internal frontiers was elaborate and time consuming"* (European Commission, 1999). Of course, this is not a rapid process – it took the EU thirty years to harmonize its non-tariff barriers. Further, the liberalization of movement in people would also be beneficial to labour markets within the region, and could take place at a pace acceptable to SACU members, given concerns over its impacts. In the EU, regulations liberalizing the movement of people were introduced after the liberalization of goods.
- Fourth, there is not a choice between aligning Botswana with Europe, North America or South Africa. Closer integration with South Africa would not be at the expense of closer trade and investment ties with other regional partners and beyond. "Trade diversion" costs should not be exaggerated. Tariffs can be a small part of the importing decision in relation to other costs (see Box 4-4). Nevertheless, closer regional integration should be accompanied by continued reductions in high external tariff walls (Hinkle, 2004).

4.6 **SADC has notified its intention to move to a customs union by 2010.** Five out of eleven SADC members are already members of the SACU customs union, and every other SADC member (with the exception of Tanzania) is also a member of COMESA. This would therefore be a very challenging initiative and force these members to decide on which customs union they should belong to.

4.7 **It seems unlikely that the SADC free trade agreement, once finally implemented, will have much impact on Botswana's gross trade flows.** Botswana already belongs to SACU and has a free-trade agreement with Zimbabwe. It has very little export trade with Malawi and Zambia (see paragraph 1.24).

4.8 **There is a problem of overlapping membership between SACU and SADC, which risks eroding the influence of both organizations if it is allowed to continue.** Of the members of SACU, South Africa, Botswana and Lesotho are members of SADC, while Namibia and Swaziland are members of both SADC and COMESA. COMESA is implementing a customs union and both SADC and COMESA have launched Free Trade agreements. One of the main costs of overlapping membership is that it undermines the harmonization agendas of competing organizations. It is ultimately counterproductive to have overlapping organizations, and unworkable if they are both customs unions. At some point, a choice has to be made, most acutely for countries in both SACU and COMESA.

The ACP-EU Partnership Agreement

4.9 **The ACP-EU Partnership Agreement, which was signed in Cotonou in June 2000,** provides for negotiating "Economic Partnership Agreements" (EPA) between ACP countries and the EU. These will comply with WTO rules on regional agreements and replace the non-reciprocal preferences that grew out of the Lomé Convention. The EU begun negotiations in September 2002 and conclude them at the end of 2007.

The EU-South Africa Trade Cooperation and Development Agreement (TCDA)

4.10 **The TCDA requires the EU and South Africa making phased tariff reductions to zero over a transition period (12 years for South Africa) on a group of products that account for 90 percent on average of the value of trade between them.** Imports from the EU to BLNS countries, provided they indicate a BLNS destination, are, at least on paper, meant to be charged the full CET tariff. However, in reality, it is likely that they enter at the lower TCDA rate. Similarly, BLNS exports to the EU can benefit from the preferential TCDA EU tariffs provided they are subject to some cumulation and value-added in South Africa before being exported. In effect, the EU may accept all SACU origin inputs as South African for purposes of calculating origin (Leith, 2004). Since Cotonou market access to the EU is better than TDCA access, this rule of origin is, however, not currently a binding constraint.

4.11 **This was negotiated without the participation of the BNLS.** It gives rise to two fears: that it will undermine competitiveness of Botswana's producers, and that it will reduce customs collection. As for the former, the key question is whether the TCDA will result in EU exports displacing some of Botswana's exports to SACU and the magnitude of any such displacement. This is unlikely, since Botswana exports few products within SACU that would be in direct competition with EU products, and there is a long 'phase-in' period. There was also concern about South Africa displacing Botswana's exports to Europe.

World Trade Organisation

4.12 SACU's consistency with Article XXIV of GATT 1994 has not yet been determined by the General Council of WTO.[24] As such, SACU is not a "customs territory" for the purposes of WTO Article XXIV and members of SACU have individual contracting status with respect to GATT 1994.

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[24] The arrangement was submitted to the WTO, but later withdrawn in view of the negotiations to reform the arrangement. In 1998, SACU was subjected to the Trade Policy Review Mechanism (TRPM) of SACU; and the report published in two volumes in 1998.

4.13 **Because of its preferential or open access to the South African, EU and US markets, Botswana faces relatively good access to its major markets.** Diamonds are allowed duty-free access to the EU market regardless of the trade regime in place. The vast majority of Botswana's other main products take place under preferential trading arrangements or the SACU customs union, hence face few tariff restrictions. Exports to South Africa enter duty and quota-free. Exports to the EU take place under the Cotonou arrangements. ACP countries are entitled to a 100 percent reduction in ad valorem customs duties. Most exports to the US take place under AGOA. Hence, possibly a more important consideration than further tariff reductions to gain greater market access is the prospect of the inevitable erosion of existing preferential market access.

4.14 **Preferences are important for food and agricultural exports.** Botswana's export weighted MFN tariff for food products to the EU is 55 percent (CEPII, 2004), while food products face only a 5 percent average *applied* tariff in the EU. ACP countries are also covered by Protocol 4 on beef and veal of the ACP–EU Partnership Agreement of 2000 which gives a 92 percent reduction in customs duties, other than ad valorem duties, applicable to beef and veal originating in the ACP States. CEPII (2004) find that, given a high level of protection on beef carcasses, there is no evidence of tariff escalation. There are currently no import tariffs or export duties on ostrich meat exports to the EU market, although export permits need to be issued for all ostrich products leaving Botswana. Ostrich leather imports to the EU do not face tariffs.

4.15 **Botswana has preferential access to several important markets for garment and textile products (Table 4-1).** As an ACP country, it has duty and quota-free access for textiles and apparel to the EU. As a member of SACU, all products can be exported to the largest regional market, South Africa, without duty or restriction. As a SADC country, its products are given preferential duty treatment when exported to SADC countries outside SACU. Zimbabwe and Botswana have a free trade agreement that dates back to 1956. Finally, under AGOA, Botswana qualifies as an LDC, or least developed country. This means that until September 2007, it can produce apparel from fabric purchased anywhere in the world and ship it to the United States duty-free. The trade preferences are valuable to Botswana manufacturers in two ways. First, it means products can be exported to the EU and US at a 16 percent to 34 percent cost advantage over other producers (Salm *et al*, 2004). Second, Botswana manufacturers can work in conjunction with other manufacturers and merchants to create competitive supply chains.

Table 4-1: Principal Trade Agreements Affecting Apparel and Textiles

Trade Agreement	Duties	Rules of Origin	Time Limit	Comments
EU-ACP (Cotonou)	Apparel- 0 percent Textiles- 0 percent	Double Transformation Change of HS heading	2008	Currently being renogotiated
SACU	Apparel and textiles- 0 percent	None- SACU duty paid on imported inputs	None	
Zim-Bots	Apparel and Textiles- 0 percent	Apparel- 20 percent local value added	None	
SADC	Garments-40 percent	Double Transformation	Duties will be gradually reduced to zero by 2008	
AGOA	Garments –0 percent Textiles-Various	-None -Yarn Forward Various-see note 2	-Sept 2007 -Oct 2007 to Sept 2015 None	See note 1. See note 2.

Notes:

1. After 2007, unless the LDC waiver is extended, Botswana garments will have to meet the AGOA rule of origin, which is yarn-forward, to qualify for duty-free status.
2. AGOA makes no provision for duty-free imports of textiles, except for handmade and folkloric items. Manufacturers in other African countries, however, can use Botswana textiles to produce garments that qualify for the yarn-forward rule of origin.

Preference Erosion for Beef

4.16 **Beef preferences can be eroded from many sources.** Of the main potential candidates (reform of the Common Agricultural Policy (CAP), increasingly expensive sanitary and phytosanitary standard (SPS) requirements, EU enlargement, new free trade agreements with Botswana's competitors and completion of the Doha Round), the first two appear to be the most substantial. The EU's current CAP reform strategy might result in a very small rise in real beef prices; but, more probably, it will result in stability. This means that Botswana can expect no increase in the real price of its exports (Stevens et al, 2005).

4.17 **Botswana is protected from full-scale competition with the most efficient producers of beef in the world in a small number of markets only, of which the EU and South Africa (plus Norway) are probably the most important.** The 'protection' that Botswana receives in the EU is mediated through the Cotonou Agreement. The trade provisions of the Cotonou Agreement are currently being renegotiated, with the expectation that many of the African, Caribbean and Pacific (ACP) group will enter into Economic Partnership Agreements (EPAs) with the EU from 2008. The negotiations are only just beginning to reach the stage of detailed product-specific discussions. There is no strong expectation that the preferential trade regime for beef will be ended. The main issue is whether it will be deepened. The two principal options for deepening are a globalisation of the current country-specific tariff quotas (TRQs) made available to the Southern African states that are able to meet EU FMD requirements, and the removal of all such quantitative barriers and the residual tariff.

4.18 **It is unclear how far Botswana would benefit from the lifting or globalisation of its Cotonou Beef Protocol Tariff Quota, since this is set at a level substantially exceeding current supply capacity.** The fact that similar TRQs apply to other suppliers to the European market probably means that Botswana benefits rather than loses from the system. Whilst the removal of its own country-specific TRQ might be beneficial in the medium term if supply could be increased, similar moves towards other suppliers (particularly those in Latin America and Australasia) would be likely to provoke a sharp fall in the prices that Botswana receives for its exports.

4.19 **The prospect of price competition pushing EU prices below their current level would be increased greatly if Botswana were to face direct competition with Latin American or Australasian suppliers.** At present, this does not happen. Together with Namibia, Swaziland and, in the past, Zimbabwe, Botswana has a preferential TRQ under Cotonou. Argentina, Brazil, Australia and other globally competitive suppliers also have TRQs in the EU market, but these are organised under the WTO Agreement on Agriculture. These quotas are not only filled, but the more competitive suppliers (such as Argentina and Brazil) are even able to exceed them, supplying a relatively small quantity of beef that pays normal (i.e., very high) MFN tariffs.

4.20 **Because both the Cotonou and WTO TRQs are small relative to the size of the European market, these imports do not significantly push down prices. But there could be competition if change were to happen in one of several ways.** One way would be for the Doha Round to result in a significant increase in the size of the WTO TRQ. The same result would occur from the successful conclusion of an EU–Mercosur free trade agreement that would provide preferential access for beef. A third route through which there could be increased competition between Botswana and non-African suppliers is if the EPA and WTO quotas were formally merged. It is too soon in the Doha negotiations to predict how likely such an outcome might be, but pressures coming from WTO dispute settlement could encourage the EU to secure its position in this way.

AGOA Expiry – The Death of the Botswana Industry?

4.21 **AGOA has been the dominant driving force behind recent growth of the apparel sub-sector in a number of Sub-Saharan countries, including Botswana.** LDC status conferred on Botswana has enabled it to receive special advantage under AGOA, in that it does not need to apply the principle of cumulation to its USA garment exports. Manufacturers are able to source highly competitive Asian manufactured cloth as their raw material input. Currently, this special LDC advantage will expire midway through 2007; and it is unlikely to be extended.

4.22 **In the woven apparel segment of the sub-sector, all factories exporting under AGOA import their raw materials from East Asia**. This represents factories employing 25 percent of the workforce in this sector. This sub-sector consists almost of entirely 'knit to shape' garment producers making knitted sweaters, jerseys pullovers, cardigans, etc. The survival of these factories is at risk if they cannot source Sub-saharan qualifying fabric before the end of the LDC preferential status in 2007. The yarns used in this industry are generally blended synthetic yarns, which are not produced in any great variety in the sub Saharan region. There is a limited variety available from South Africa; but most yarn is imported from China and Taiwan. The scale of the industry makes it unlikely that a dedicated yarn spinning mill could be set up to create the variety of yarns necessary to create the range of products required. If there is no relaxation of the USA rules of origin and the LDC preference is not extended again, this section of the industry will have to totally divert to the European and regional markets because the industry would not be competitive in the USA, in its present form without preferential access. Unlike the woven apparel industry, knit to shape garments made in Botswana are eligible for duty free access into the European Union because they fulfil the Rules of Origin requirements of conversion from thread to garment; i.e., the fabric and the garments are made in a qualifying state.

4.23 **Among the options for Botswana apparel manufacturers to minimize this impact are**:

- Shift market focus away from the USA to other markets, such as Europe or SADC, where the rules of origin are not as restrictive.
- Shift market focus to SACU, where duties on fibre, yarn and fabric is still lower than on garments.
- Shift the sourcing of raw material to AGOA eligible countries. Even if the materials cost more, Botswana apparel may still be price competitive if the additional cost does not exceed the advantage from being duty-free. There is a residue of trained operators in the country from previous cycles of investment and industries which could potentially use Zambian yarn, which qualifies for export preferences under AGOA, and is currently in plentiful supply.
- Reduce manufacturing costs through improved labour and material efficiency.

- Reduce manufacturing costs by investing in more automated equipment. The best opportunity for this is converting from hand-flat to automated flat knitting.
- Shift market focus to less price sensitive markets, such as niche markets, and concentrate on competing on product, response and quality.
- Shift production to apparel made from fabric and yarn that is considered in short-supply in the USA (see next paragraph) and, therefore, still duty-free to the USA under AGOA.

4.24 **The last item is an important opportunity that has not received full attention from African garment manufacturers.** Under AGOA, apparel made from yarn and fabric that is not available in commercial quantities in the United States can be exported duty-free to the USA from AGOA eligible countries without any limit.

Textiles and the MFA Phase-Out

4.25 **The ten year ATC (Agreement on Textiles and Clothing) expired at the end of 2004, and with it the Multi-Fibre Arrangement (MFA).** Under the terms of the MFA, countries set quotas for imports of various apparel products from major apparel producing countries; - no quotas are now imposed on apparel imports since 2004, although duties can still be imposed. As a result, it is expected that major low-cost apparel producing countries, most notably China, will take a greater share of the apparel export market.

4.26 **There is no doubt that some buyers will switch from Africa suppliers to Asian ones, particularly those in price sensitive markets segments.** On the other hand, there are a number of reasons that this might not be as serious a threat as often feared:

- Many buyers do not want to source all their products from a single country or region, and Africa offers a reasonable alternative source to Asia.
- Price is not the only point of competition in apparel. Africa supply chains offering quicker response times, smaller production runs, and greater product flexibility could still compete with Asian suppliers.
- African apparel meeting the rules-of-origin can still be imported duty-free into the USA and Europe.
- China and other low-cost Asian producers do not have an infinite capacity to expand production. As production expands, cost pressures there are likely to increase offsetting some of the price advantage.
- As of the end of 2004 (the time of the sub-sector study), there was no major exodus of apparel manufacturers or buyers from the region. In fact, several apparel producers in Botswana have plans to increase production. The same pattern is seen in other apparel producing countries outside Asia, such as Turkey. It appears that most of the buyers who are going to switch to Asia have already done so, or will do so only gradually.
- Nevertheless, this is a significant price competition threat, which like the beef sector requires major efforts to increase efficiency. This involves improving production techniques and technology, reducing delivery times, lowering costs, and finding and adopting production to more specialised niche markets.

Non-Tariff Barriers

4.27 Non-tariff barriers pose a more significant constraint to Botswana's exports than applied tariff levels. While across the region the more obvious non-tariff barriers – foreign currency controls, import licensing, price controls and state marketing – have been removed, a number of more non-transparent and arbitrary NTBs remain. For exports outside of the region, complex rules of origin and onerous standards and SPS requirements act as a substantial barrier to exports.

4.28 One possible reason for Botswana's lack of trade with its non-SACU neighbours is a plethora of arbitrary NTBs. Many of these are product-specific, sometimes of seasonal or limited duration, as listed in Table 4-2 below.

Table 4-2: NTBs in the SADC Region

NTB	Primary Reason	Remedy
Non-acceptance of SADC Certificate of Origin	Non-notification of change of verifying signatures	Efficient communication from national authority to SADC Secretariat
Changes in road and border tolls	Short-term revenue generation	Adherence to SADC Protocol agreements by national authorities
Temporary bans on selected products	Local industry protection, vested interests, health protection	In some cases the actions appear arbitrary and without clear justification.
Non-acceptance of certificates and trade documentation	If the documents are in order then often due to corrupt practices at border posts	Improved administration and anti-corruption operations at border posts
Visa requirements	Lack of harmonisation and revenue seeking	SADC regional integration processes
Non-acceptance of national Standards	Inability for verification at national level, lack of regional accreditation processes	Increase national investment in Standards Authorities, harmonise Standards at the regional level
Pre-shipment Inspection	Prevent transfer pricing and under-invoicing	Most SADC countries have done away with PSI, arguing that it has proven to be an expensive, time consuming and often ineffective control mechanism
Poor collection and dissemination of trade data	Inadequate human resources, lack of computerisation.	This is a serious NTB inhibiting effective trade policy formulation and the identification of particular trends that may be having an unfavourable impact. The use of the SADC CoO is still very difficult to quantify.

Source: SADC Non-Tariff Barriers Synthesis Final Draft Report

Rules of Origin

4.29 **Rules of origin restrict trade with SADC, the EU, the US and other trading partners.** Rules of origin are a central component of preference regimes, and are often the most important non-tariff barrier. One problem is the varying and complicated nature of such requirements, as demonstrated in Table 4-3 outlining the different approaches taken by OECD countries.

Table 4-3: Rules of Origin for Textiles and Apparel

	EU	Canada	Japan	USA
Rules of origin – type	Mixture[25]	60 percent domestic value added	Change of tariff heading	35 percent domestic value added + extra rules on clothing
Rules of origin – cumulation	Full ACP and EU	Full GPT and Canada	Japan only	SADC, WAEMU + extra cumulation for clothing

Source: Stevens et al (2004)

4.30 **In addition to AGOA, the power of rules of origin is also highlighted by the Zimbabwe-Botswana trading relationship**. Zimbabwe tolerated textile and garments imports from Botswana through the bilateral trade agreement as long as they did not impact too seriously on the indigenous industry. A relocation of Zimbabwean entrepreneurs to Botswana, coupled with serious labelling fraud and transfer pricing, resulted in a flood of apparel and textiles that started to flow across the border. This began to damage the Zimbabwean industry, and a number of relief measures were sought and obtained. In short, the Zimbabweans imposed a number of qualifying rules of origin (including on what are 'allowable costs' under local content rules) on Botswana clothing and applied these in such a way that the door was effectively shut.

4.31 **Non-tariff barriers within SADC risk making the current trade protocol irrelevant**. Rules of origin has proven to be the most contentious part of implementing the protocol. Current rules of origin will be very difficult to satisfy for regional producers and will therefore hinder regional vertical integration (Brenton,et al 2004). The 'double transformation rule' is in reality redundant in the face of restrictive rules of origin imposed under AGOA or by the EU, and cost-raising where exports are not constrained by such rules in export markets. SADC Member States plan to address this issue as a follow-up discussion to the SADC Mid-Term Review. Special rules of origin have been applied to certain sectors (e.g., motor vehicles and sugar), and negotiations for other sectors are still ongoing—most notably textiles and garments, and wheat and flour:

- **For textiles and apparel,** imported raw materials will have to undergo a minimum of two stages of production ("double transformation") before they can be considered to have originated in a SADC country. This is done ostensibly to promote the development of backward linkages. However, in practice this represents a particularly expensive method of protecting domestic producer interests at the expense of consumers.

- **For vehicles and components,** the SADC ROOs are a constraint to selling into SADC markets (Brenton, Flatters and Kelenga, 2004). The chapter rule for HS87 sets a maximum import content of 60 percent of ex-works price. There are also specific rules containing provisions on maximum import content and required production processes – the maximum import content for vehicles is between 55-60 percent, while for components it is generally between 40-50 percent. Very few firms in Botswana can satisfy these conditions, thus limiting Botswana's ability to sell to non-SACU members of SADC. This is much more restrictive than US AGOA rules of origin faced by SACU's exports.

[25] The EU's rules of origin require a two step conversion process to achieve duty free access. Although less onerous than the AGOA three step rule, Botswana's classification as an LDC makes penetration of the USA textiles market at present easier than the EU.

4.32 **The rules of origin legislation of the TCDA grants BLNS products full cumulation**. Moreover, certain measures aim to provide these rules with greater flexibility. These include a value tolerance rule giving South Africa room for manoeuvre. Limited derogations from the rules of origin are also possible. Fisheries products are covered by certain additional rules.

4.33 **Rules of origin played an important role in the closure of the large Hyundai plant in Botswana in 2000.** The plant, costing USD60 million was built in Gaborone to assemble Hyundai motor cars from knocked down kits, for sale to South African market. The manufacturers were Hyundai franchise in Botswana. The venture obtained BDC loan of $24 million and the same amount from two Dutch banks. In 2000 the plant was closed due to heavy losses, which had a number of contributory factors, reportedly including a failure to reach the break even level of 15000 vehicles per year; the inimical attitude of the South African motor lobby, and possible fraud by the owners. One of the reasons for the failure of the plant was a dispute over rules of origin. The plant imported semi-knocked down parts, which were then assembled in Botswana and sold into the highly protected SACU auto market. After the plant started operations South Africa challenged that there was insufficient value-added taking place and ruled that the products failed the rules of origin requirements as originating from Botswana. South Africa used SACU Article 11(5) to oblige Botswana to cooperate in the fulfilment of 'economic objectives′ of its import control legislation for the auto sector.

EU SPS requirements

4.34 **The EU is the major market for beef and ostrich meat exports, and imposes stringent SPS regulations, which are becoming ever more troublesome and costly to implement.** Even though some of them may go beyond the standards set by the *Office International des _pizooties* (OIE),[26] in practical terms Botswana has no option but to comply. There also appears to be a tendency in other high-priced markets to take EU certification as 'a seal of approval' that adequate SPS standards are maintained. This means that compliance with the EU's requirements is necessary not only to continue exporting to Europe, but also to many other high-priced markets for both beef and ostrich meat sales.

4.35 **In the beef sector, a part of the reason for BMC's failure to operate at full capacity has been the closures required from time to time to deal with animal disease outbreaks.** Foot and mouth disease (FMD) outbreaks closed the Lobatse abattoir for four weeks in 2002 and six weeks in 2003, and the Francistown abattoir for 5_ months in 2002 and for over half of 2003 (for sales to the EU). In addition, though, the cost of complying with the EU's SPS regulations has increased, much of this is borne not by BMC, but by Government; hence, it is a subsidy to the beef sector.

4.36 **In broad terms, the variable costs of compliance are borne by Government and the capital costs in the abattoir and post slaughter are borne by BMC.** The new traceability system for cattle, which involves the placing of a bolus in each cow, is said to have cost Government P150 million. But BMC have had to install new facilities in the abattoirs, both for its part in the Livestock Identification and Trace Back System (LITS) and for other SPS-related improvements. The capital cost of SPS compliance is not identified in the BMC's *Annual Reports*, but clearly needs to be a matter for further research.

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[26] This would provide a benchmark should any actual or potential exporter seek to use the World Trade Organization's (WTO) dispute settlement mechanism.

4.37 **Estimates for the cost of compliance are difficult to generate.** Government does not provide figures for expenditure on the beef sector alone, but between 1994/5 and 2003/4 the budget of the Ministry of Agriculture rose in current terms by 241 percent. The expenditure estimate of the Department of Animal Health and Production as a whole rose over the same period by 220 percent, accounting for 47 percent of the Ministerial total by the end of the period, whilst that for FMD control shot up by 271 percent. Another 'cost' is the transactions costs incurred by farmers. It is argued that the hassle of selling to BMC is rising, not least as a result of EU requirements. As a result of a November 2004 inspection by EU vets, for example, it is now necessary for all cattle to be transported to BMC in sealed trucks once a livestock movement permit has been issued by the field division of the Department of Veterinary Services. This removes, at least temporarily until the bolus system is fully operational, the possibility either to trek the cattle or to move them in more open vehicles. Taken together with the risk of an animal being condemned at the abattoir, all of this has reduced the incentive to sell to BMC to below the price premium offered over sales to local butchers or for informal slaughter.

4.38 **Botswana has the technical capacity and political determination to meet new EU SPS standards so long as these are of a reasonable nature.** The response to the heightened traceability and BSE-related requirements (which has included a raft of new legislation as well as the LITS) is impressive. The Botswana College of Agriculture and the Meat Inspection Training Centre appear to fulfil the requirements of Regulation 854/2004 (CEC 2004). The issue is not willingness and capacity; it is cost.

4.39 **In the ostrich sector, the Botswana Ostrich Company (BOC) recognises that compliance with EU hygiene standards is costly, but cannot currently isolate and quantify such costs.** One of their concerns is that the multi-species abattoir is required by government to meet stringent EU standards for all its slaughter operations, including cattle service slaughters for domestic beef processors. This renders the abattoir less competitive in slaughter service provision, relative to its domestic rivals. For example, the BOC service-slaughter charge on cattle stands at P100 per head, whereas city council abattoirs charge only P30 per head for the same service.

4.40 **In 2001, the European Commission's Health and Consumer Protection Directorate conducted a mission to Botswana** which found the overall position on animal health 'satisfactory', but requested a number of assurances. It was a further three years before the abattoir was finally cleared. The abattoir, which began operation in March of 2002, was approved for export to the EU market only in August of 2004. Since being granted such approval, the abattoir has been able to export small quantities to Belgium: other EU market destinations have not been targeted due to small supply-side volumes. In order to ensure that EU standards are adhered to, government veterinary officers and meat inspectors have been deployed to work full-time at the abattoir. Most have previous experience with beef export compliance to the EU.

Other Non-Tariff Barriers

4.41 **South Africa uses import permits to restrict the importation of used goods – in particular clothing and cars.** This does not directly affect Botswana's exports, although it does add to the cost of imports and the cost of transportation, which is an indirect cost for exporters.

4.42 **Import permits are required for agriculture products in most SADC countries.** In some cases this is used to protect industries, such as the poultry sector in Zambia, which could have an impact on the potential of Botswana poultry to export. South Africa imposes an import ban on live animals – all animals that could bring 'mad cow' disease (Bovine Spongiform Encephalopathy) into the country are banned. Such measures are generally seen to arise from concerns over public safety, rather than from any covert protectionist measure (Imani, 2004).

4.43 **South Africa imposes specific levies on some imported and domestically produced agricultural products.** On products from Botswana, this includes R0.02 per kg of imported beef. Funds from these levies are used to promote research on the levied goods.

4.44 **Centralised buying programs from South African supermarkets** are sometimes referred to as a barrier to supplying the regional market. However, Botswana's poor record of supplying these supermarkets even for domestic sales suggests that the weak supply capacity of Botswana producers is the constraint, rather than any kind of institutionalized bias or restriction against BLNS African suppliers. Local sourcing is only 10 percent for Shoprite in Botswana, compared to a regional average of 52 percent (Charalambides, 2004).

4.45 **Visa restrictions act as a non-tariff barrier in terms of restricting the flow of business travel in the region**. There is no provision in the new SACU agreement to allow for the freer movement of people. If SACU is to move towards a single market, this is an important step towards its achievement.

4.46 **SACU Article 17 triggers safeguard action** if the products, say of an industry in a BLNS-country, enter South Africa in large quantities″ as to cause or threaten serious injury" to South African producers or manufacturers. And, since almost any successful new industry in a BLNS-state is likely to be one which will very likely, either″ cause or threaten serious injury" to South African producers or manufacturers, potential Article 17 restrictions can be invoked.

4.47 **Local content requirements:** these are used in all SACU countries. In particular, South Africa requires exporters who qualify for credit facilities from the Industrial Development Corporation to have a minimum local content of 70 percent. Local-content considerations are a criteria in comparing tenders for government procurement. Further, there are certain restrictions on loans from South African banks to foreign companies. The South African Music and Television Local Content Regulations establish minimum local-content requirements for TV and sound broadcasters. Changes and possible lack of clarity in SACU local content requirements played a role in the demise of the Hyundai car factory established in Botswana in the 1990's, which went bankrupt, with substantial losses that ultimately fell on Government (as the main funder of the company).

RECOMMENDATIONS - MARKET ACCESS ISSUES

- Botswana should launch a concerted lobbying effort to improve rules of origin in all preferential trading agreements, starting with a Government-initiated 'rules of origin' strategy paper. In particular, this could advocate for the Economic Partnership Agreement with the EU to allow for single transformation of goods such as found in the AGOA agreement with the United States. In addition, Botswana should lobby for simplified and liberalized SADC rules of origin in the SADC MTR follow-up discussions (quota restrictions should be removed and the derogation should become the general rule for all SADC Member States). Botswana should press within SACU for a concerted and more liberal approach to rules of origin – SACU has been resistant to relaxing rules of origin within SADC, insisting on higher local content to qualify for preferential treatment than other SADC members would like to accept (paragraph 4.30).

- Botswana should lobby the EU to improve existing trade preferences for beef products to allow customs duty, quota and special duty free export of a wider range of beef and meat products, without excessive administrative and sanitary restrictions (paragraph 4.17).

- Botswana should continue to lobby for the AGOA LDC provision to be made permanent in order to provide predictability for potential investors in a particularly unstable market (paragraph 4.21).

- Botswana should prepare detailed estimates of the costs of compliance in order to fully assess the costs and benefits of the current emphasis on sales to the European Union (paragraph 4.37).

DOMESTIC PROTECTION AND THE TERMS OF TRADE

4.48 **Botswana is in an unusual position: a bias towards domestic production within SACU does not translate into a domestic investment bias towards domestic import-competing production because of the existence of the SACU customs union.** In fact, the 'customs union effect' alters the standard terms by which tariffs alter incentives, and standard trade theory may not be the best indicator of 'resource pull' within SACU. Trade protection has had less of a distortionary impact than might be expected because protected industries exist largely in South Africa rather than Botswana. Nevertheless, there has still been some impacts on factor prices, investment switching to non-tradeable products and some protected industries, consumer welfare and efficiency. This section attempts to assess these impacts.

4.49 **Botswana is a member of a number of regional arrangements, the most important of which is the South African Customs Union (SACU) in terms of the scope and depth of economic integration.** Botswana shares a common external tariff (CET) and common tariff rebate schemes with other members of SACU, although the country still maintains some control of the use of non-tariff barriers such as import permits, licensing and standards, and the SACU infant-industry protection clause. Key features of the CET and non-tariff protection profile are:

- High dispersion, from 0-325 percent, with a simple average tariff of 8 percent and an import weighted average of 6 percent
- A cascading tariff and a high tariff variance: low tariffs on inputs (zero tariffs cover almost 70 percent of ROW imports, 53 percent of tariff lines)
- Complex structure: 46 ad-valorem bands, 25 percent of tariff lines using specific rates
- 'Nuisance tariffs' (<2 percent normally cost more to collect than revenue)
- Moderately restrictive non-tariff barriers – mainly anti-dumping and rules of origin

4.50 **High and low tariff rates, reflecting a policy of keeping input tariffs low and maintaining high nominal tariffs on some final products.** The tariff profile largely reflects the interests of South Africa, the dominant country in SACU. The revenue-raising objective is not the primary objective of tariff policy in SACU. The tariff profile has its origins in a policy of infant-industry protection practiced by South Africa as an attempt to develop its industrial base, based on tariffs, export incentives and quantitative restrictions (Rangasamy and Harmse, 2003). South Africa now has a number of highly-protected industries, set alongside export competing industries with duty-free status.

4.51 **Following South Africa's offer to the GATT in 1994, there has been a substantial reduction in SACU tariffs.** The average applied import weighted tariffs fell from 28 percent in 1990 to 10 percent in 1998 (IMF, 2000). Using the WTO definition, tariff protection is 9.6 percent for agricultural products (up from 9.4 percent in 1997), against 11.6 percent for non-agricultural products (down from 15.7 percent in 1997). The simple average rate of the 2002 applied MFN tariff is 11.4 percent (Table 4-4), down from 15 percent in 1997. Forty-three point four percent of all tariff lines are set at zero. Particular product groups face average tariff rates of 30 percent and above. These include apparel (HS 61), clothing accessories (HS 62), tobacco (HS 24) and carpets (HS 57). About sixteen of the HS chapters contained average tariff rates above 20 percent and these were mainly on clothing products (60, 61, 62, 63), footwear (64), umbrellas (65), tobacco (24), beverages (22), preparations of cereals (20), fish and crustaceans (03) and meat and edible meat offal. Duty-free items include: live animals, products of animal origin, ores, fertilizers, cork, pulp of wood, silk, some minerals (e.g., nickel, lead, zinc), and other base metals.

4.52 **While South Africa's WTO offer includes a tariff rationalization program to reduce the number of tariff categories from over 100 to six, only a small reduction to 41 bands has so far taken place** (Cassim, Onyango and Seventer, 2003). There is still a confusing number of specific, ad valorem, mixed, compound and formula duties, as described in Table 4-4. There has, nevertheless, been some simplification of tariffs under the South African-EU TDCA and under the SADC FTA. Prior to this liberalisation effort, the protective structure ranked amongst the most complex in the world. The present CET remains complex, despite progress in reducing overall tariffs and their escalation since the 1980s, with frequent efforts to target tariffs by introducing more detailed classifications and fine tuning (more than 2000 changes annually in some recent years) (Cassim, Onyango and Seventer, 2003). Less complexity would increase transparency, reduce the scope for protectionist lobbying, and therefore facilitate trade. It would also facilitate the implementation of the SADC free trade area, which will require a degree of tariff harmonization and coordination among participating members (Cassim, Onyango and Seventer, 2003).

4.53 **Further, there is still a wide dispersion in tariff levels, which increases effective rates of protection and inefficiencies.** While tariff reforms have eroded the margins of tariff escalation, protection is still much higher for consumer than for capital or intermediate goods. SACU's tariff variance of 128 is relatively high, although it compares favourably with countries such as the United States (135), Kenya (177), Norway (157) and Romania (137) (from Kee, Nicita and Olarreaga, 2004a – note that the higher the figure the higher the variance). Kee, Nicita and Olarreaga (2004b) estimate that this tariff variance actually increases the welfare-reducing impact of SACU's tariff by almost 50 percent.

Table 4-4: Structure of MFN tariffs of SACU, 1997-02

(Per cent)

	1997	2000	2001	2002	U.R.[a]
1. Bound tariff lines (percent of all tariff lines)[b]	96.4	96.4	96.4	96.2	96.4
2. Duty-free tariff lines (percent of all tariff lines)	42.4	44.6	44.5	43.7	9.9
3. Non-*ad valorem* tariffs (percent of all tariff lines)	25.6	24.8	24.6	25.0	0.0
4. Tariff quotas (percent of all tariff lines)	8.1	7.4	7.2	7.3	7.2
5. Non-*ad valorem* tariffs with no AVEs (percent of all lines)	25.6	24.8	24.6	25.0	0.0
6. Simple average bound rate	..	..	..	..	20.9
Agricultural products (HS01-24)	..	..	..	..	46.8
Non-agricutural products (HS25-97)	..	..	..	..	18.1
Agricultural products (WTO def.)[c]	..	..	..	..	43.5
Non-agricultural products (WTO def.)[d]	..	..	..	..	18.1
7. Overall standard deviation of bound rates	..	..	..	..	25.5
8. Simple average applied rate	15.0	12.8	12.0	11.4	n.a.
Agricultural products (HS01-24)	11.4	11.3	11.4	11.5	n.a.
Non-agricutural products (HS25-97)	15.4	12.9	12.0	11.4	n.a.
Agricultural products (WTO def.)[c]	9.4	9.3	9.4	9.6	n.a.
Non-agricultural products (WTO def.)[d]	15.7	13.1	12.3	11.6	n.a.
9. Domestic tariff "spikes" (percent of all tariff lines)[e]	4.0	5.8	4.5	3.9	2.1
10. International tariff "spikes" (percent of all tariff lines)[f]	39.4	34.4	34.1	34.8	50.9
11. Overall standard deviation of applied rates	17.8	15.1	13.9	12.6	n.a.
12. "Nuisance" applied rates (percent of all tariff lines)[g]	0.2	0.0	0.0	0.0	n.a.

a Namibia, South Africa, and Swaziland's final bound rates statistics. Botswana concessions are the same except on some products. Lesotho bound its tariff at a ceiling rate of 200 percent on agricultural products and of 60 percent on non-agricultural products.
b Refers to Botswana, Namibia, South Africa, and Swaziland. Lesotho bound 100 percent of its tariff.
c WTO Agreement on Agriculture.
d Excludes petroleum.
e Domestic tariff spikes are defined as those exceeding three times the overall simple average applied rate (indicator 8.).
f International tariff peaks are defined as those exceeding 15 percent.
g Nuisance rates are those greater than zero, but less than or equal to 2 percent.

U R WTO Uruguay Round

Note: Indicators 1 and 4 are calculated taking into account all tariff lines (i.e. in-quota and out-of-quota lines).

Source: WTO SACU Trade Policy Review, 2003.

4.54 **More than 90 percent of imports into Botswana enter under preferential trade tariffs, either originating from within SACU or externally.** However, for imports originating from outside of SACU this does not make a very large difference to the average tariff. In fact, for EU and SADC agreements, the impact of converting *non-ad valorem* tariffs into *ad valorem* tariffs[27] offsets the tariff reduction on other tariffs. Further, EU exports to Botswana face rules of origin restrictions under the TDCA and a number of sensitive sectors

[27] For example, a combined tariff of "40 percent or 54 percent with a maximum of 3590c/kg" in the MFN schedule is converted to an ad valorem tariff of 40 percent for EU imports and 35 percent for imports from SADC.

for Botswana – such as beef - were excluded from the final agreement. Other bilateral agreements include an agreement with India signed in 2001, reciprocal duty free trade with Zimbabwe, and a reciprocal customs agreement with Malawi. However, these agreements make little impact on the overall tariff profile, since Zimbabwe accounted for only 4 percent of Botswana's merchandise imports (2001) and the Malawi agreement is rarely used. Tariffs on imports from SADC countries are due to decline significantly. A US-SACU Free Trade Agreement is under negotiation, with the potential to further reduce tariffs and liberalise services between the two regions.

4.55 **For non-preferential trade, the outcome of WTO Negotiations may also have an impact on SACU's tariff and non-tariff trade rules.** It is not yet clear what impact this will have upon SACU. WTO tariff cuts are based on bound tariffs, which Botswana has bound above applied tariffs, reducing the potential impact of WTO tariff reductions upon applied tariffs.

Non-Tariff Barriers

4.56 **Imports into Botswana are also subject to a variety of other restrictions, such as quantitative restrictions, import bans, rules of origin and anti-dumping duties.** Recent World Bank research estimates that the *ad volorum* (or 'tariff') equivalent of 'core non-tariff barriers' (including restrictions such as anti-dumping and safeguard restrictions, quotas, import bans and minimum prices) for South Africa is 3.83 percent. This is above the average of 3.16 for a sample of 94 major developed and developing countries included in Kee, Nicita, and Olarreaga (2004b).

4.57 provides a snapshot of the current NTBs in SADC countries presented in a recent SADC-commissioned report on NTBs.

Table 4-5: SADC Non-Tariff Barriers

Activity	**SADC MEMBER STATES**											
	Angola	Botswana	Lesotho	Malawi	Mauritius	Mozambique	Namibia	South Africa	Swaziland	Tanzania	Zambia	Zimbabwe
Notification of NTB National Contact Points	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Core NTBs												
Cumbersome Customs procedures & documentation	5	2	3	3	1	5	3	2	3	4	3	3
Cumbersome import licensing/permits	4	3	2	3	2	3	3	2	2	2	3	3
Cumbersome export licensing/permits	3	2	2	2	3	3	2	1	2	2	2	2
Import and export quotas	1	2	2	1	2	2	2	3	2	1	1	2
Unnecessary import bans/prohibitions	1	3	1	2	2	1	1	1	1	1	2	1
Other NTBs												
Restrictive charges not being import or export duties	3	1	1	1	2	3	2	1	1	1	1	1
Restrictive single channel marketing	4	2	1	2	3	2	2	1	3	2	1	3
Prohibitive transit charges	3	3	1	2	1	4	2	2	1	3	2	2
Cumbersome visa requirements	4	3	3	2	2	3	2	3	2	2	2	2
Restrictive technical regulations	1	2	2	2	2	2	3	3	2	3	2	2

Scale 1-5: 5. Very Serious, 4. Serious, 3. Moderate, 2. Low, 1. Nil

Source: SADC Non-Tariff Barriers Synthesis Final Draft Report

4.58 **Do non-tariff barriers constitute a serious constraint to Botswana's potential exports by raising the costs of inputs for exports or increasing the anti-export bias in key sectors?** A recent analysis showed that anti-dumping duties significantly increase SACU's tariff protection. For example, while South Africa's non-tariff barriers are imposed on a relatively small percentage of products (9 percent of tariff lines) lines, they impose an additional barrier equivalent to an average of 43 percent on these products. The variance of these *ad valorem* equivalent estimations of NTBs ranges from 0 to 348 percent. The main contributor to these tariff-raising barriers is the use of anti-dumping duties (see Box 4-3). The sectors that are most protected by NTBs are apparel, beef, footwear, fish, glass, and wood products.

4.59 Chapter 5 below details a number of barriers to trade in the transport, shipping and customs area. **But there are also a number of actual or potential trade policy-related non-tariff barriers**:

- An **'infant-industry clause'** was placed in the renegotiated 1969 SACU agreement. This allowed for time-limited protection for new industries. However, Botswana has only used this clause twice and with limited success – a soap factory and a brewery were established which did not perform well and the original investors sold out. This lack of success in an early experience with infant industry protection has led to little use of this instrument (Leith, 2002).
- Botswana makes use of **import licensing and import bans** on the imports of some agricultural products (bread, beef, fish produce, eggs, chicken and (when in season) oranges, cabbages, tomatoes, and milk (see paragraph 3.94)). The limits amount to an import ban for beef, milk and bread. The objective is to protect domestic suppliers from competition. For example, Botswana imposed a ban on the importation of **bread** in October 2003 to support local bakeries. Some consumers had hitherto chosen higher-quality imported long-life bread, but were denied this choice by the ban. The ban was imposed without prior notification to traders other than a one-day notice – when some imports were already in transit. The protected bakeries were not new 'infant-industries'; the measure was a classic case of protection of (inefficient) local firms at the expense of consumers, and certainly ran contrary to the spirit, if not the letter, of the SACU agreement. A further new import limitation has been placed on the import of second-hand vehicles. New measures to ban the import of all **second-hand vehicles** that are more than five years' old are being considered at the time of writing. This would be enacted ostensibly on safety grounds, but is more likely initiated to protect largely South African producers from imports of reconditioned Japanese vehicles.
- At present, **imports of fresh, chilled and frozen beef from South Africa (but not canned beef) are banned**. In recent years, this has been flanked by an SPS ban on the grounds that some South African beef is hormone treated and there is said to be a danger resulting from the possibility of South African livestock having been fed with feed containing animal protein. Contamination from either source would prejudice Botswana's exports to the EU.

Box 4-2: Should Government Remove the Export Monopoly of the BMC?

- A removal of BMC's monopoly could be made either in relation to exports to the South African market or for all exports. At the present time, it seems improbable that any organisation other than BMC would sustain substantial exports outside the region. Whilst the ostrich abattoir could, perhaps, be used for slaughtering beef for export to the EU, only BMC has established cold storage and transport facilities. Given the low throughput for export at present, it seems unlikely that it would be cost effective for any competitive firm to leap in for the non-SACU market. The reason for removing the ban on non-BMC exports to South Africa is that this may be the market of the future. Simulations conducted for the background study suggest it would continue to be commercially viable for Botswana to export to South Africa for some time after it has ceased to be sensible to do so to non-regional markets.
- The most appropriate competitive framework in any situation is influenced partly by the nature of the product and partly by the nature of the market. It is accepted that there are certain 'natural monopolies'. There is also evidence that, under some circumstances, restricted-channel exporting can achieve greater gains than the alternative both for technical reasons (economies of scale, etc.) and for reasons of power: the distribution of gains along a value chain will be influenced by power relations between the actors from the producers via exporters, and importers to retailers. Whilst it is beyond the scope of this paper to assess where the balance lies in the beef sector, it is valid to suggest that there may be differences between the EU and South African markets in this respect. Because of its proximity and the nature of meat demand, in the case of South Africa there is an argument in favour of offering a highly differentiated range of products in different packages to different sub-markets. The efficiency gain from a single exporter that accrues from minimising fixed-cost expenditure on the supply chain would be less marked than in the case of the EU, where the goal is to build niche markets for a limited range of products. The efficiency loss of forgoing competition between different operators would tend to be greater for exports to South Africa than to the EU. Hence, the balance of gains and losses from having a monopoly exporter is likely to be different when considering the EU market on the one hand and South Africa on the other.
- The downside of such a change would be that, to the extent new operators export prime beef successfully to South Africa, it would tend to depress still further BMC's throughput. However, such are the demand-side problems facing Botswana that this loss may be less substantial than the possible gains.

- **Rules of origin also restrict imports, thus raising the anti-export bias.** SADC rules of origin restrict the potential imports to SACU with the SADC free trade area, thus limiting the potential competition and cheaper input prices made available through the agreement (see paragraph 4.30).
- Other than the diamond industry controlled by Debswana and meat exports controlled by the BMC (see Box 4-2), there are no **export cartels or examples of single channel marketing**.
- **Anti-dumping and safeguard practices** add another layer of protection.[29] South Africa is historically the sixth largest initiator of anti-dumping cases in the world, although the number of new cases initiated has fallen in recent years (from a peak of 21 to six in 2001 and four in 2002). The higher import tariffs ('anti-dumping duties') apply to the imports of all SACU members. The protected products are largely products of concern to South Africa and raise the cost of inputs for Botswana producers (see Box 4-3).

[29] SACU is not a heavy user of safeguard measures, and has imposed no new measures in recent years.

Box 4-3: Do Anti-Dumping Duties raise the price of inputs and raise the anti-export bias?

- On a trade-weighted basis, safeguard measures add little to overall protection, although they do make a significant difference at the individual product level. Anti-dumping duties feature in 19 of the 100 most protected SACU tariff lines ranked by the ad valorum equivalent of non-tariff barriers.
- Critically, exporters are not exempted from anti-dumping tariffs on their inputs. Rebates and exemptions are only allowed on 'schedule 1' tariffs, whereas anti-dumping duties are 'schedule 2' tariffs.
- A study by Holden (2002) reviewed South African-initiated anti-dumping cases initiated between 1991-1998. This found that only 3 percent of successful applications were likely to have involved anticompetitive behaviour on the part of the foreign suppliers. Holden suggests that 'dumping' to the South African market was instead primarily driven by considerations of market expansion, cyclical changes in the world economy and state trading. Critically for SACU exporters, most of the challenged products (with the exception of four products - blankets, cotton underwear, bed linen and car tyres) were intermediate products in the production process. Intermediate products typically face a lower level of tariff protection in South Africa, ranging between zero and 28 percent tariffs even before the late-1990s liberalisation. But antidumping duties, which were set at between 15 and 202 percent and averaging 52 percent, increased this protection considerably. Holden notes that a striking sixty nine percent of the applicants were the sole manufacturer of the product in South Africa. An additional concern of the Botswana authorities is that of 'dumping' by countries within SACU, particularly by South Africa, although this study yielded no concrete examples.

During the SACU liberalization process, the textile industry was one of the few industries that had experienced an increase in effective protection (Holden, 2002). South Africa imposed 43 percent duties on over 80 types of cotton fabric defined at the 8-digit level of the Harmonized System. Chemicals form the largest single sector for initiated cases (37 percent). Chemical and rubber products make up approximately 10 percent of Botswana's imports. Similarly, machinery, mechanical and electrical appliances make up a further 9 percent of anti-dumping cases and constitute 19 percent of Botswana's imports.

Effective rates of protection for SACU and Botswana

4.60 **A recent assessment (TSG, 2003) calculated effective rates of protection**. This used firm level surveys to gather input/output data[30]; it describes relatively high effective protection provided to some industries by SACU tariffs (**Error! Reference source not found.** overleaf).

Table 4-6: Botswana Effective Rates of Protection (percent)

		Botswana		Simple Average		Weighted Average		Simple Average - W/O Duty Drawback		Weighted Average - W/O Duty Drawback		Simple Average - With Duty Drawback		Weighted Average - With Duty Drawback	
2dig	Description	Firms	Products	MFN_FINAL	MFN_INPUT	MFN_FINAL	MFN_INPUT	ERP_W	ERP_D	ERP_W	ERP_D	ERP_W	ERP_D	ERP_W	ERP_D
1	Agriculture And Forestry	1	1	0	0	0	0	0	0	0	0	0	0	0	0
4	Food Processing	5	12	11	13	25	33	-401	48	-253	127	0	48	0	127
7	Textile	2	6	13	41	26	46	-12	66	-63	148	0	143	0	535
8	Clothing	6	18	21	48	22	42	-63	150	-88	151	0	205	0	103
9	Leather and Footwear	1	1	10	30	10	30	-1	36	-1	36	0	36	0	36
10	Wood and wood Products	1	2	7	16	7	16	-81	166	-81	166	0	166	0	166
11	Furniture	1	4	7	21	7	21	-81	243	-81	243	0	243	0	243
13	Publishing	1	1	10	0	10	0	-6	-6	-6	-6	0	-6	0	-6
15	Basic chemicals	1	2	3	3	3	5	0	13	0	26	0	14	0	26
16	Industrial Chemical	5	21	5	14	8	15	-7	35	-10	44	0	35	0	44
18	Rubber	1	1	11	8	11	8	-29	2	-29	2	0	43	0	43
20	Glass and Ceramic	1	1	0	5	0	5	0	60	0	60	0	60	0	60
22	Other non metallic	1	1	1	0	1	0	0	0	0	0	0	0	0	0
23	Iron and Steel Products	2	2	7	5	7	2	-44	33	-11	-3	0	33	0	-3
24	Fabricated Metal Products	1	3	6	0	6	0	-7	-7	-7	-7	0	-7	0	-7
26	Electric machinery and appliances	1	1	6	0	6	0	-7	-7	-7	-7	0	-7	0	-7
30	Other manufacturing	1	1	15	20	15	20	-52	41	-52	41	0	77	0	77
31	All other products	1	2	1	0	1	0	-4	-4	-4	-4	0	-4	0	-4

Source: The Services Group (2003)

[30] The SADC Economic Impact Assessment Survey is based on firm-level data and on nominal tariff and protection data at the HS 6 digit level.

4.61 **Anti-export bias is the difference between the ERP for domestic markets and the international markets.** A positive ERP indicates that a domestic activity provides higher returns to capital and labour than would prevail under free trade. Using standard tariff analysis, tariffs raised the incentives for Botswana companies to serve the domestic SACU market above the world market by raising the profitability of doing so by on average 88 percent for a sample of 33 firms surveyed in Botswana by TSG. *Relative* levels of effective protection are particularly important. If one sub-sector gets a lot more protection than another, then the potential distortion of resources and inputs becomes more acute (although, as noted below, this does not necessarily imply an efficiency loss in a customs union).

4.62 **The most protected sectors according to the TSG analysis are food processing, textiles, clothing, wood products and furniture production.** Protection on processed foods enables producers to serve the domestic market with 128 percent more value-added (profit) than without tariff protection. For textiles, the picture is even more stark: production for the domestic Botswana market or to other countries in SACU is 535 percent more profitable than it would have been without protection. Comparable figures for other sectors are 103 percent for clothing, 166 percent for wood and wood products, and 243 percent for furniture. The profile shows wide variations between sectors, ranging from high domestic ERP for textiles of 535 percent and for electric appliances of –7 percent. Negative ERPs exist for sectors, such as publishing, iron and steel products, fabricated metal products, and electric machinery and appliances, where final imports face relatively low protection, but where inputs face tariffs. This analysis did not include non-tariff barriers, which would serve to increase the overall protection further on some products.

So is there an anti-export bias?

4.63 **There are a number of mechanisms through which barriers may have some impact on incentives for exporters.** Some of these apply in Botswana, others do not:

- **First, by reducing consumer welfare, thus reducing national income and investment:** Leith (1992) estimates that SACU resulted in costs for Botswana through a static welfare loss equivalent to 1.24 percent of GDP – i.e., the revenue formula was not compensating Botswana for the loss associated with the high external tariff and the polarization of trade in SACU. A dynamic model could show a higher cost to SACU tariffs since this would include the dampening effect of tariffs on productivity and efficiency. This lost national income has eroded Botswana's stock of human and physical capital. Cheaper imports would lead to higher disposable income and savings, higher investment and lower input costs for domestic manufacturers. However, a 'trade diversion'-based analysis has been disputed for some products (see Box 4-4).

- Box 4-4: Evaluating trade diversion: the realities "on the ground"

- While the theory of trade diversion is clear, evaluating the extent to which it is occurring is often difficult and varies according to the situation "on the ground". The problem is that business often operates in a "second best" world where factors other than price are important. For example, in the context of Zambian horticultural exports, we came across South African companies providing packaging to the export growers at prices that were significantly above those sold by European producers on world markets. Taken at face value, the conclusion would be South African exporters were surviving as a result of tariff preferences. However, discussion with their clients revealed that key factors were the availability of trade credit, the ability to buy in small units (with the possibility of return), and ready access. In contrast, the large European producers insisted on cash before delivery and would only provide bulk orders. Transactions that appeared to be the result of trade diversion were in actuality driven by the need to overcome the constraints in the financial markets in Zambia and the resulting importance of cash flow.

- Customs procedures and practices will also impact on trade diversion. An important example for the region is that of vehicles. While tariff rates are similar throughout the region, in COMESA countries, the importation of second hand cars enables consumers and businesses to reduce the higher transport costs resulting from the tariff. However, in SACU, measures are currently being considered that will effectively restrict second hand car imports. In Namibia, second hand tyres from outside Customs territory are already restricted on health and safety grounds, in Botswana, customs is investigating "under invoicing" of imported second-hand cars; and in South Africa, registration of imported second hand cars is problematic for owners. The same tariff leads to a very different impact in terms of trade diversion.

- Source: Charalambides (2004)

- **Second, by switching demand and therefore investment towards protected industries:** high tariffs have *generally* not led to the development of a large number of protected industries in Botswana because of the polarization of production in SACU, whereby South African firms account for about three-quarters of Botswana's imports. There are therefore only limited examples of sectors that benefit from high tariffs. Such activities, while employment generating, can draw investment and skills away from more efficient and possibly export-oriented activities. Tariff or non-tariff protection also reduces the incentives and pressure to take efficiency-raising measures to improve competitiveness in the protected sectors;

- **Third, some exportable products are protected**: **textiles and clothing** tariffs have raised the price of clothing on the domestic market throughout SACU, making it more profitable to sell into the domestic market and to South Africa. In the **beef sector**, Botswana's beef producers (like those in its SACU neighbours) receive protection in the form of a 40 percent external tariff. This, together with the ban on imports of cattle and fresh meat contribute to the high domestic price of beef and the difficulties of BMC in finding sufficient quantities of beef for export. Liberalisation of beef imports could increase the supply of beef to BMC. In South Africa, the 40 percent external tariff is rebated to importers that channel imported beef into processed products.[31] Since Botswana has a ban on imports of cattle and fresh meat

[31] South Africa currently accommodates the divergent interests of its beef producers – including emerging farmers whom the government wishes to encourage – and its consumers in a protein-deficient country by offering a duty rebate to processors that import beef. In this way, competitive imports are channeled into the processing industry and do not normally compete head on with the fresh product. It remains to be seen whether this arrangement will continue into the medium-to-long term, especially if the protein deficit increases and if the Doha Round (or its successor) agrees to significant cuts in agricultural tariffs across the board (or nearly so).

from South Africa, the question of adopting a similar system does not arise at present. However, in the industrial sector and advanced countries it is commonplace to have intra-industry trade – there is no reason in principle why the same should not occur in the agricultural sector, with the region importing larger quantities of forequarter meat partly in order to release hindquarter meat for export.

- **some import-substitution takes place behind high tariffs and NTBs:** import-substitution is not as extensive in Botswana as it has been in some other developing economies. However, there are some examples of industries that benefit from various forms of protection, including flour milling, furniture production, egg production, and dairy production.

- **by switching demand and, therefore, investment from tradeables to non-tradeables:** while investment and skills may not have been diverted to import-competing industries, has the trade profile increased the price of non-tradeables (e.g., services – banking, insurance) relative to internationally tradeable products? Concerns have been expressed that the strong growth in domestic services such as the retail sector and financial and business services, with an annual growth of above 8 percent, is the result of an anti-export bias in the economy. Higher costs of imports because of the SACU tariff (either sourced from outside SACU or South Africa) will mean demand switches away from imports to non-tradeables – i.e., the domestic service sector.[32] This would increase the relative profitability and therefore investment into these sector relative to export sectors. It is likely there has been some tariff and NTB-induced distortion of this nature, although it has been difficult to measure its magnitude. The growth in the non-tradeable services sector has actually coincided with falling tariffs in recent years, and is more likely driven by the public sector and the typical growth in services associated with economic growth (see Box 1-1).

- **Fourth, by taxing raw materials and capital goods used for the production of exports:** for raw material inputs, Botswana has implemented a well-functioning system of duty-drawbacks and duty exemptions common to all SACU countries. Further, for machinery and capital goods used by exporters, most – but not all – machinery imports are zero-rated for tariffs and exporters can have their VAT on machinery imports refunded. However, anti-dumping duties on imported raw materials are not rebated or exempt to exporters, thus this duty is passed on as a price increase. Box 4-3 described how most of these duties have been on intermediate inputs. Further, some capital goods used in the export process are still more expensive because of tariff protection. The transport sector is a good example. Trucks are not considered as machinery, hence face non-zero tariffs and VAT. Motor vehicles face particularly high tariffs, as described in Box 3-2 above. Tariffs on computer equipment were reduced to zero only in 2004 after successive requests by the Botswana authorities. Further, some industrial materials still face tariffs, such as steel which faces a tariff of 5 percent, furniture tariffs of approximately 20 percent, transport equipment tariffs of approximately 12 percent, and printing and publishing tariffs of approximately 7 percent. Ostrich feed – comprising soya oil cake and maize – faces a SACU duty at 6.6 percent and R0.1374 per kg respectively.

[32] While some services are tradeable, the majority are sourced domestically given service trade restrictions. SACU does not include free trade in services – key services sectors subject to trade restrictions include banking, insurance and telecommunications.

Protection of Services

4.64 **There are major barriers to trade in services both in Botswana and across SACU countries and beyond.** In particular, domestic regulation segments services markets in banking, insurance, telecoms and transportation services. Trade in services is regulation-intensive and liberalization is frequently a matter of streamlining government regulations or eliminating state-sanctioned monopoly providers. Chapter 2 has set out the business costs associated with high utilities costs. Expanding trade in services represents an important avenue for increasing Botswana's global integration. Imported services are often critical for improving domestic production (and exports) in manufacturing and agriculture. Importing services can serve as one channel for technology transfer, particularly if locals can imitate foreign providers of services.

4.65 **Botswana has much to gain from providing the freest possible market access to providers of professional services (e.g., law, architecture, technical) and financial services.** Developing export-oriented service industries is also one way to overcome the natural resource constraints that Botswana faces beyond minerals. An example is tourism. Open markets to foreign providers of services, along with investments in physical infrastructure, hospitality industries and marketing can contribute to a thriving domestic tourism industry.

4.66 **Botswana has made commitments under the GATS to existing liberalization in a few sectors**. Botswana has committed to under 5 percent of all possible WTO GATS services commitments, which is less than the average developing country index of 6.9 percent (WTO TPR, 2003)[33]. In particular, it has committed to having no limitations to market access and national treatment on services for consumption abroad in professional business services, computer and related services, real estate, and tourism and travel related services. For the latter, it has committed to hotels and restaurants, and travel agencies and tour operators. However, many other areas are 'unbound'. There are no GATS commitments on supply of services by temporary movement of people nor (generally) on cross-border trade. This means in some cases that the service has to be supplied through commercial presence by a supplier who meets all the normal residency requirements. Botswana is not a signatory to GATS agreements on basic telecommunications or financial services, and has made no commitments on financial services, while in telecoms, she has only a commitment in courier services.

4.67 **Access to services does not form part of the SACU agreement.** In September 1999, the SADC trade negotiating forum was mandated by the SADC ministers of trade to work towards the liberalisation of 'Trade in Services'. The mandate is based on Article 23 of the SADC Protocol on Trade, which recognises the importance of trade in services and requires member states to adopt policies and implement measures in accordance with their obligations under the General Agreement of Trade in Services (GATS) with a view to liberalizing the services sector in the region. Negotiations are ongoing for a SACU-US Free Trade Area in which services liberalization would be a major component.

[33] To determine this measure, the number of their GATS commitments on market access and national treatment are divided by the possible number of market access and national treatment commitments for all sectors in all modes of supply.

RECOMMENDATIONS - DOMESTIC PROTECTION AND THE TERMS OF TRADE

- The Botswana authorities should refrain from using import bans as a tool to sustain local enterprises against foreign competition. This is an arbitrary measure that is borne by the consumer and contributes to the anti-export bias. Government should reconsider the effective import ban on bread and not impose new restrictions on imports of second-hand vehicles (Paragraph 4.59).

- Botswana should use its influence in the new SACU Secretariat to reenergize the liberalization efforts of SACU. This effort should include: a phased program of tariff reforms that would continue the progress made during the early liberalization period in the 1990s. This should focus on:

    - Botswana reducing SACU's average applied rates (which would be strongly in Botswana's interest).
    - Botswana urging SACU to accelerate its tariff rationalization program to reduce the number of tariff categories from 41 to six, in line with WTO commitments (paragraph 4.52).
    - Botswana lobbying within SACU for the number of anti-dumping initiations to be further reduced (Box 4-3). Government should initiate a short follow-up review of the impact of anti-dumping duties on the cost of Botswana's business inputs. Government to advocate the development of tighter rules on anti-dumping for all WTO members through the WTO Doha Development Agenda.
    - SACU setting up a monitoring program of NTBs in similar fashion to a COMESA exercise.
    - Government reviewing the impact of liberalizing beef imports with a view to discussing this with SACU neighbours (paragraph 4.63).
    - Botswana urging SACU to develop a regional approach to easing visa restrictions over the longer run, starting with a SACU visa, possibly including SADC members (paragraph 4.45).
    - Botswana proposing a tightening of SACU members' ability to make use of Article 17 (paragraph 4.46).
    - Botswana proposing SACU-wide limitations on the use of local content requirements that restrict the ability of other SACU members to trade with their SACU neighbors (paragraph 4.47).

5. TRADE FACILITATION AND INFRASTRUCTURE

5.1 **The World Bank estimates that landlocked countries have only 30 percent of the volume of trade of average coastal economies.** In a study of shipment costs from Baltimore, the cost of a shipment to Durban (South Africa) is US$2500, whilst the cost of a shipment to Maseru (Lesotho) via Durban is US$12 000 (World Bank, 2002: 107). Further, in East and Southern Africa, air transport costs are on average ten times higher than for Florida in the US (World Bank, 2002: 100). In addition to raising transport costs, inefficient or poor quality transport services can also adversely affect the cost structures of firms. Firms may, for example, have to hold higher levels of inventory: in developing countries, inventory holdings in the manufacturing sector are 2 to 5 times higher than in the US. It is estimated that cutting inventory levels in half could reduce unit costs of production by over 20 percent (Naude, 2001). How much is distance and cost of transport holding back Botswana's export development in goods and services, and are their other obstacles prohibiting the movement of goods and people? This chapter tries to explain the major constraints to trade, drawing in part on the sub-sector research conducted for this study.

5.2 **Botswana has a number of key features to its trade facilitation regime: proximity to major South African markets, distance from major developed country markets, and – as a landlocked country - reliance on transit through its neighbours, primarily South Africa.** Botswana is only four hours by road to the major South African conurbation of Johannesburg. Botswana's exports to the US and EU largely pass through the port of Durban, which is just 9 hours by road from Gaborone. Transport links to other countries in the region are driven up by poor and fragmented infrastructure in neighbouring countries. Transportation costs for imports of intermediate and capital inputs, and exports from Botswana to South Africa and beyond, are high. For exports requiring ports, Botswana faces high inland transportation costs to Durban. The average cost to send a 40 ft. container to Durban from Gaborone is approximately Pula 12,000 (US$2460) to 14,000 (US$2870).

CUSTOMS PROCEDURES, MANAGEMENT AND VISA RULES

5.3 **Customs clearance procedures were recently reviewed and simplified prior to implementation of an UNCTAD project to install the ASYCUDA^{++} computer system in all the main customs clearance points in the country.** Apart from import permits issued by MTI, the requirements for supporting documents with customs declarations are consistent with the practice elsewhere. As a result, FIAS (2004) concluded that there is limited scope for further simplification of customs procedures. The Botswana Freight and Forwarders Association report a big improvement in Customs services in recent years. Imported goods are checked randomly. Goods generally clear the same day at customs, although there are reports of occasional delays at the Tlokweng border gate (see below).

5.4 **A national customs transit procedure is effective in managing the transit of goods from or through South Africa and Nambia to Botswana.** Electronic submission of declarations by direct trader input is in operation. Most goods imported via Durban pass through a "dry port" and are then cleared in Gaborone – goods are usually transited through South Africa under the standing bonds of freight forwarders. Botswana's imports from South Africa are cleared at the border, and so long as the sales invoice price includes transport to Botswana, are exempt from South African VAT. Botswana VAT of 10 percent is payable at the border.

5.5 **Some form of security is required from customs clearing agents, processors of imported materials for export, and from VAT registered traders who defer payment of import VAT.** Security may be given as a cash deposit, or payment may be guaranteed by a banking or insurance institution acceptable to Customs (a "bond"). As in other countries, the use of bank and insurance guarantees is allowed so as to avoid cash deposits, which present cash flow constraints for traders. Customs estimates that approximately 40 percent of traders use guarantees. Letters of credit (L/Cs) are used by exporters in Botswana to provide security of payment for their goods. As an alternative to L/Cs, insurance is available from the Botswana Export Credit Insurance and Guarantee Company (BECI), a parastatal.

5.6 **Imported inputs for export production clear customs largely without unnecessary restrictions.** Manufacturers, who are registered with Customs for duty-free treatment, do not have to pay duty or VAT on raw materials for the manufacture of goods to be exported from the SACU common customs area. Certificates of authorisation are provided by the Department of Industrial Affairs, MTI. The goods are manufactured under bond and under customs supervision. When the goods are ready for export, Customs attend the container loading at the manufacturer's premises, and seal the container, which is then subject to simplified export control. Hence, payment of duty by the importer and subsequent payment of duty drawback by Customs is avoided (FIAS, 2004). This is particularly important since companies would not want to tie up their scarce cash-flow, particularly in a high interest rate environment.

The VAT Differential

5.7 **Despite being major trading partners, Botswana's VAT rate (introduced in 2002) is 10 percent while South Africa's is 14 percent - this difference creates a second economic border**:

- **For exports *through* South Africa, the South African authorities recently made it a requirement that all Botswana freight companies forwarding goods by road to Durban for export must pay VAT, then have it reimbursed.** This objective was to mitigate the risk of hijacking or pilferage of goods.[34] This refund can take a long time, prompting some exporters to use rail when they would otherwise use other forms of transport (FIAS, 2004). Importers have complained that SARS overcharges for this service, making deductions for service charges and using an undervalued Pula in its Rand/Pula exchange rate. A further resulting restriction is on the time allowed for the groupage of products within South Africa - the exporter or freight forwarder must prove that goods left South Africa within 30 days or face a penalty. This rule makes it difficult to containerise goods in South Africa prior to exporting.

- **Goods exported from Botswana *to* South Africa are liable for South African VAT of 14 percent.** Proof is required that goods picked up by South African importers in Botswana are destined for export from Botswana to South Africa. This is generally avoided by exporters delivering their goods to South Africa, who usually pay the VAT and add this to the amount payable by the South African importer.

[34] Customs transit controls or South African VAT are not normally imposed on goods carried by rail on a through bill of lading.

- **For imports *from* South Africa to Botswana, the shipper applies for a VAT refund from South African authorities and then pays VAT to the Government of Botswana.** The need to file paperwork with two different countries and the time to obtain a refund from South African authorities unnecessarily increases the costs of conducting international trade.

5.8 **A further complication is introduced by differing customs electronic platforms between South Africa and Botswana.** Subsequent to Botswana introducing ASYCUDA, South Africa has introduced an Electronic Data Interchange network as its customs management system. Traders with South Africa, therefore, still need to fill out forms manually to clear goods.

5.9 **Paper work associated with clearing customs is perceived as burdensome.** Although electronic documentation is now available in the larger customs offices, it must still be accompanied by a paper version as paper documentation is still regarded as the only legal declaration. The problem of documentation procedures across all SADC countries has been raised in the context of the SADC Mid-Term Review.

Table 5-1: Documentation Requirements

	Namibia	Botswana	Swaziland	Mozambique	Zimbabwe
Tax invoice			X		
SDN		X	X		
CCA1	X	X	X	X	X
Commercial Invoice	X				
BW 500		X			
Health Certificates	X	X	X	X	X
Permits	X	X	X	X	X
BOE				X	X
SARS export certificate	X	X	X		
All require Bank Clearance F178 if the value of the invoice is over R50,000					
Source: Information provided by Woolworths Ltd. Cited in TSG/ USAID "Mid Term Review of the SADC Trade Protocol" (2004) at www.satradebub.org					

5.10 Exports to Zimbabwe require verification of rules of origin by Botswana Customs if the goods are exported under the Botswana/Zimbabwe Trade Agreement.

5.11 **The Department of Customs and Excise is exploring the concept of a 'one-stop border post' with South Africa to reduce border crossing time.** This should be strongly encouraged - the customs union's common external tariff is undone to some extent if individual countries use different procedures.

5.12 **A further step in the long-run would be to move towards creation of a regional SACU customs authority.** This would ensure common procedures, reducing transaction costs for shippers, and would take advantage of economies of scale in data processing. SACU border posts would then be responsible for the collection of information, controlling immigration, import standards enforcement (e.g., avoiding importation of potentially diseased cattle), and enforcing different ownership requirements for firearms, ownership of which is more restricted in Botswana.

Border Clearance

5.13 **Clearance at border posts is relatively fast.** During peak times, delays can occur at Tlokweng border post with South Africa; although this does not normally create delays of more than a few hours. This border handles the vast majority of Botswana's road traffic (both imports and exports). Border delays would be reduced further if the Tlokweng border, in particular, had 24 hour opening – at present it is open from 0600 to 2200 daily. For border gates on the Trans-Kalahari Highway, if complete and correct documentation is presented, fully laden trucks importing goods into Botswana or travelling in transit can clear customs, immigration and weighing formalities in less than 30 minutes at both the Mamuno and the Pioneer Gate border posts with Namibia and South Africa, respectively. During certain peak periods in the morning there is a backlog of trucks waiting to be processed, although this is usually cleared in 2 or 3 hours. Minor coordination and communication problems have been cited for SADC border posts.

Box 5-1: FIAS (2004) Recommendations on Customs Changes

- ❑ Government should review the level of resources of the Department of Customs and Excise with a view to strengthening capacity to audit traders.
- ❑ The Department of Customs and Excise should introduce proficiency examinations for clearing agents as soon as possible.
- ❑ Government should investigate the difficulty firms have in obtaining insurance company cover for bonds.
- ❑ Government should improve lifting equipment at the GABCON dry port.
- ❑ Government should review the number of import permits required, with a view to minimizing the number required.
- ❑ Government should request SARS to review the method for making repayments to make them WTO compliant.
- ❑ Government should request SARS to grant greater time allowances for consignments sent to South Africa by freight forwarders for consolidation
- ❑ SACU members should develop a transit system that covers movement through all SACU member states.

5.14 **However, weak and inefficient customs in neighbouring countries creates significant barriers to regional integration.** The textiles sector is a good example. Zambia and Zimbabwe are both sources of high quality, medium staple cotton fibre that is sought after for ultimate production into garments for major export markets. At the moment, both countries export a significant portion of their cotton as raw lint. Botswana is in a position to attract investment in the more capital intensive spinning, weaving and dyeing stages, and is much more likely to do so than Zambia or Zimbabwe. Cotton yarn spinning does exist in both Zambia and Zimbabwe, and the quality and costs of such production are competitive for world markets. Thus, in addition to the opportunity to spin cotton from these countries, Botswana manufacturers can also use the spun yarn for further processing into fabric and garments. This regional linkage, therefore, has the potential to support supply chains that are competitive on both price and quality. To effectively exploit these opportunities, one important issue has to be addressed. The transit corridor from Zimbabwe and Zambia is currently subject to delays and complications at the Zambia-Zimbabwe, Zimbabwe-Botswana, and Zambia-Botswana borders. Most of these problems are not with customs on the Botswana side.

Border constraints to tourism

5.15 **Botswana's central location in Southern Africa and the fact that it borders four countries places it at the centre of the Southern Africa tourism circuit.** The Kasane/Chobe areas have a particularly significant advantage, being located at the meeting point of 4 countries – Botswana, Namibia, Zambia and Zimbabwe. This location potentially allows visitors a unique opportunity to experience some of Africa's most exceptional natural attractions within a short period of time.

5.16 **However, the absence of a coordinated and tourist-friendly immigration and customs system at the various entry points could result in major frustrations and lengthy delays, and could impact negatively on the visitor experience.** For example, the various countries all have different immigration and customs requirements and tax regimes, with the result that visitors have to go through a variety of differing procedures in order to move between the different countries. This makes a quick round trip between Botswana, Zimbabwe and Zambia a major exercise with the visitor having to pass through six border control points, often having to wait in long queues, paying a variety of steep entry taxes and wasting valuable time. Entry to Zimbabwe has become difficult over the last two years, with very long queues at the Kasane to Victoria Falls border post.

5.17 **Slow progress has been made with implementing a universal Southern Africa regional visa as proposed and accepted by SADC. Since this still seems a long way off, a special effort should be made to improve ease of access between the four countries mentioned above.** The introduction of a single, special tourist visa that could be approved and purchased in advance of the visit at a foreign office of any of the four countries, which will provide access to all four countries, should be investigated. The latest technology could be employed to avoid abuse and fraud, and the fees generated could be distributed according to an agreed formula among the participating countries. A special service could be introduced at the various immigration points to process tourists who are in possession of the visa.

5.18 **Other items that add to the relatively high cost levels are the multiple taxes that apply when combining Zimbabwe and Botswana in a regional travel package.** When entering Zimbabwe from Botswana, for example, four fees are payable by foreigners namely a visa fee, a vehicle permit fee, a carbon tax and third party insurance fee. These are paid at different locations at the border post and require separate documentation to be completed.

RECOMMENDATIONS - CUSTOMS PROCEDURES, MANAGEMENT AND VISA RULES

- Develop a program for VAT harmonisation by SACU members, including an assessment of costings comparing the revenue gains/losses with estimates of the economic losses associated with the increased transaction costs of the VAT differentials (paragraph 5.7). Further, Government to propose development of a transit system that covers movement through all SACU Member States.

- Lobby South African authorities to extend time allowed for groupage (containerization) of products in South Africa before they are liable for South African VAT (paragraph 5.7).

- Explore the concept of a 'one-stop border post' with South Africa to reduce border crossing time (paragraph 5.11).

- Explore desirability of moving towards a regional SACU customs authority (paragraph 5.11).

- Implementation of FIAS (2004) Customs Recommendations (Box 5-1).

- Government could set up a 'complaints/ suggestions' box at the main border posts following a similar initiative by COMESA states (paragraph 5.13)

- Customs and Excise to open Tlokweng border gate on a 24 hour basis (at present it is 0600 to 2200) to reduce congestion (paragraph 5.13).

- Government to explore the scope for the introduction of a single, special tourist visa that could be approved and purchased in advance of the visit at a foreign office of any of the four tourism circuit countries (Botswana, Namibia, Zambia and Zimbabwe), which will provide access to all four countries (paragraph 5.17).

- Government to explore scope for reducing or combining multiple taxes that apply when combining Zimbabwe and Botswana in a regional travel package (paragraph 5.18).

- Botswana should push for an effective agreement on trade facilitation in the WTO that reflects the varying implementation capacities of developing countries and reduces constraints to trade. It should also continue to use existing regional fora, such as SADC, to tackle these obstacles (paragraph 5.14).
- Government should propose SACU-wide limitations on the use of local content requirements that restrict the ability of other SACU members to trade with their SACU neighbors (paragraph 4.47).

SHIPPING AND PORTS

Costs and Efficiency

5.19 **A recent review of maritime transport by UNCTAD estimated that freight costs as a proportion of total import value were 12 percent for developing African economies, compared to 8.21 percent for all developing countries and 4.5 percent for developed market economies.**[35] Amjadi and Yeats (1995: 8) estimate that transport costs as a proportion of value of total exports has, on average, increased from 11 percent to 15 percent during the period 1970-1991 for Sub-Saharan African countries. In contrast, it decreased for developing countries in Asia and the Americas, and indeed developing countries overall.

5.20 **Due to Botswana's location, substantial transport hauls are required to link it to major markets beyond South Africa.** Almost all of Botswana's non-diamond exports are shipped. These are mainly beef, textiles and copper nickel. For South Africa, shipping costs make up to 60 percent of transport costs for exports (Naude, 2001) – this figure is likely to be lower for Botswana only because the costs of transport to port are higher. Table 5-2 sets out costs from Gaborone to Antwerp, Belgium for a 25 MT 12 metre long refrigerated container (a "reefer"). This shows how, for a typical shipment to Europe, the per-kilometre cost of the 1500km trip to the port is triple the cost of shipment per kilometre (approximately 1.5 Euros per kilometre compared to 0.6 Euros, respectively).

Table 5-2: Land & Sea Transport Costs August, 2002

Note- The cost of the 1500 km road transport leg is 38 percent of the 7 times longer sea leg to

DESCRIPTION	Pula/Kg	Euro/Kg
Road Transport to Walvis Bay (P14,110/Euro 2,229)	0.56	0.09
Sea Transport to Antwerp (P37,240/Euro 5889.94)	1.45	0.23
Transit and Export Credit Insurance	0.07	0.01
TOTAL COST PER KILOGRAM	2.08	0.33

Antwerp. Source: Imani Consulting.

5.21 **Estimates are not available to compare 'fob' (cost without freight charges) unit values to 'cif' (cost including freight charges) value for Botswana.** Table 5-3 sets out the shipping costs for a standard container from Mauritius to Botswana.

Table 5-3: Shipping Costs- Mauritius to Botswana March, 2002

SEAFREIGHT RATES Vat 12 percent	
1 X 20FT/6M CONTAINER- Mauritius to Gaborone:	US$ 2,200
BAF (Bunker Adjustment Factor)	US$ 50
B/I Fee	US$ 35

Rates are applicable for prepaid shipments only
Transhipment via Durban
Rates are subject to THC, if any.
Source: Imani Consulting.

5.22 **Naude (2001) estimates that shipping costs from South Africa are significantly above world prices – with the margins on imports almost 50 percent higher than the average for developing countries.** Despite a general reduction in shipping costs worldwide over

[35] See www.unctad.org/en/docs/rmt01sum.en.pdf

the last three decades, costs in South Africa have risen. About 90 percent of shipping to and from South Africa takes place through foreign registered vessels (Naude, 2001).

5.23 **Government regulation in South Africa is not the primary reason for these high shipping costs.** South Africa maintains an open maritime policy which includes: i) no cabotage rules, ii) no multilateral, bilateral or unilateral cargo reservation, iii) no flag preference or flag discrimination and iv) no government attempt to influence prices and terms. Formal state involvement does occur under the Ocean Freight Agreement – a tripartite agreement between the South Africa Europe Container Service carriers, the Government and the Perishable Products Exports Control Board. This requests carriers to provide a certain quality of service, suppliers to export citrus and deciduous fruit exports, the government to ship public sector cargoes on conference vessels and to use moral persuasion to generate support for the conference from private shippers (observed in the breach). Floor and ceiling rates are re-negotiated annually (Chasomeris, 2002).

5.24 **An important component of maritime transport costs is seaport efficiency.** South Africa's port turnaround times tend to be up to 5 times longer than that of competitors (Naude, 2001). Port clearance on average takes two to three days – there are many complaints about congestion, especially at Durban port (although not exclusively).

5.25 **Most imports are on 'CIF' terms - shipping for most imports to Botswana is arranged by the seller using well-established routes via Durban and is included in the sale price.** Most freight rates are standard with little scope for negotiating rates for small shipments of the size of Botswana's shipments. Private freight companies suggest that Government, a major importer of goods, does not provide sufficient scrutiny to the transport costs of its imports.

Walvis Bay and the Trans-Kalahari Corridor

5.26 **Using Walvis Bay, Botswana manufacturers can reduce shipping time to Europe and the East Coast of the United States by a week or more over Durban.** Despite its greater distance from Gaborone,[36] the Port of Walvis Bay in Namibia offers an alternative route via the Trans-Kalahari highway linking Pretoria to Walvis Bay via Botswana. Container handling at Walvis Bay is more efficient than the port of Durban, and shipping times to Europe are on average 8 days shorter (although a similar cost). According to some officials, there is less pilferage of goods in Walvis Bay than in Durban Port. Most of the vessel calls are direct call to and from Europe, although direct call to the USA has not yet been established, in part because Walvis Bay is not yet certified for export directly to the USA.

5.27 **The Walvis Bay port is considered to be efficient and well run with spare capacity.** Throughput has increased in recent years, in part because the container vessel calling frequency has increased, resulting in a maximum dwell time of 4 to 5 days, with an average of less than 3 days. Imports and exports are no longer subject to wharfage charges (a value based tax), which are now based on real costs. The services between Walvis Bay and Europe are direct. Walvis Bay offers an advantage over Cape Town, however, in that it has zero delays, whereas Cape Town is often overbooked, resulting in frequent delays. Namport's measurement indicates that cargo remains in port for an average only of 18 hours, without experience of delays. They guarantee a transit time of 48 hours to Gauteng

[36] Walvis Bay is considerably further from Gaborone than Durban – about 1600km by road to Walvis Bay compared to 1100km to Durban.

and are actively looking to take business from that area. With a transit time of 5 days to Durban, this presents a significant saving even for Gauteng firms in South Africa in terms of both time and cost.

5.28 **In August 2004, a memorandum of understanding was signed between South Africa, Namibia and Botswana initiating the implementation of single customs documentation.** Ease of transit via the corridor is further enhanced by the quality of infrastructure and extension in border hours between both Botswana and Namibia and Botswana and South Africa.[37] In the same period that cargo handling increased via the port of Walvis Bay, road cargo traffic on the TKC has grown as much as threefold. Table 5-4 lists the services currently offered by Walvis Bay to Europe and the US.

Table 5-4: Shipping services currently offered by Walvis Bay to Europe and the US

Walvis Bay	Frequency	Sailing Route	Transit Times (minimum – maximum)
To Europe	Biweekly	Direct	18 - 21 days
From Europe	Weekly	Direct	18 – 21 days
To US	Weekly	Via Cape Town / Durban	20 - 23 days
To US	Weekly	Via Dakar	38 - 43 days
To US	Biweekly	From Dakar	+/-18 days

5.29 **However, the Walvis Bay route has so far not proved attractive to exporters, and export traffic to and from Botswana is still low.** The initial disappointing results for usage stimulated efforts to tackle the constraints to using this route. Several barriers hinder the uptake of services offered by the Walvis Bay Corridor:

- Lack of export traffic (supply side volumes) resulting in reluctance on the part of shipping companies to expand their service offerings, viz., direct sailings to and from the US. Lower calling frequency of vessels cancel out the benefits of a shorter sailing time;
- Lack of back haul freight on the Trans-Kalahari Corridor which raises the cost of shipping products to Walvis Bay for export. Many trucks taking products for export to Walvis Bay have to return empty, thus raising the cost overall;[38]
- Walvis Bay has not yet been selected by the US Customs Service as a "safe port". Direct sailings to the US, therefore, have to go through the designated "safe ports" of Durban or Cape Town;
- Lack of awareness in the market (particularly among South African operators), and conservativeness of the transport sector. Firms tend to keep to the routes they know; and forwarders, for example, are reluctant to invest extra effort in creating new offices.

5.30 **Advocates of Walvis Bay fear that South Africa is opposed to the scheme**, and argue that greater use of Walvis Bay would, in fact, decrease congestion at Durban port and offer an alternative route for exports from the Gauteng region in South Africa.

[37] Border hours between Botswana and Namibia extend from 6h00 to 24h00.
[38] The freight charges are reported to be about 3 times more than the easterly direction.

- Box 5-2: Textiles and Walvis Bay

- One of the key issues affecting the response competitiveness of the apparel supply chain in Botswana is the transport route to market. Currently, most exports are routed via Durban's port, in spite of this not being the most efficient system in terms of congestion, delays and uncertainty. A major opportunity exists for the apparel sector in Botswana to switch the transport route to the Walvis Bay Corridor, which presents a potential 30 percent time saving compared to current transit times through SA.
- Shorter shipment time to the US could be a significant boost to the textiles and garments sector in Botswana. For textiles and garments, response time and response reliability are important factors in some market segments. The biggest cause of delayed shipments in the apparel supply chain is the delivery of finished fabric to the apparel manufacturer. In response-sensitive markets, this is the weakest link in the supply chain. One of the main reasons for the weakness of this link is the fact that fabric finishing can have a high percentage of re-works due mostly to colour matching problems. When the fabric has to be shipped long-distances, particularly by sea, it is only economical to ship container loads at a time. As a result, if part of fabric order is delayed due to production problems, often the whole order will not be shipped if it means sending less than container loads.

RECOMMENDATIONS - SHIPPING AND PORTS

- Government to work with the Walvis Bay Corridor Group and other authorities to encourage greater use of the Walvis Bay route. This could be achieved by aggressive and continuous marketing to be directed at both suppliers and shipping agents
- Government should commission a study to obtain comprehensive measurements of the volume and type of freight traffic if there were a coordinated effort by private sector groups to use Walvis Bay.
- Government to develop an index of CIF and FOB values for Botswana to enable better monitoring of shipping costs (paragraph 5.21).
- BEDIA could request the Southern African Global Competitiveness Hub to facilitate efficient transportation over the Zambia-Zimbabwe-Botswana transportation corridor in the same way that it has for the Trans-Kalahari and Dar-Lusaka corridors.
- Government to undertake a review of government-procured shipping costs to assess whether greater price pressures could be introduced into the market. This could review whether government should import FOB[1] and open transit to tender from national and international importers (paragraph 5.25).

LAND TRANSPORTATION

5.31 **Botswana has a relatively well-developed and well managed land transport infrastructure.** The length of the road network is about 10,500 km and has not grown significantly over the last few years. The Trans-Kalahari Highway, completed in 1998, links Botswana to Namibia.

5.32 **The cost for Botswana exports to reach port, while substantially below that of Zambia and Zimbabwe, is high.** Table 5-5 compares the transport cost to ports from landlocked SADC countries. Three auto-component exporting firms interviewed for this study reported that the costs of transport from Durban to Gaborone and back for raw and finished products constitute nearly 60 percent of total transport costs. Transport costs were also a major constraint to textiles competitiveness. In the beef sector, transport costs have increased for BMC in recent years, although this is mitigated by some of these costs being passed on to BMC's transport subsidiaries. BMC accounts show the cost of freight, storage and other selling expenses. The cost of freight, etc., as a share of sales revenue has tended to increase for BMC – from an annual average 12.4 percent of revenue for the period 1985 to 1987 to a 16.3 percent average for the period 2001 to 2003. Hence part of the costs incurred by the BMC abattoir when exporting accrues as revenue to the subsidiary transport and storage companies that handle its meat.

Table 5-5: Transport cost to ports for landlocked SADC countries – US$ for a 20-foot container

	Cost to port
Botswana	1149
Swaziland	486
Zambia	3200
Zimbabwe	2400

Source: Coughlin *et al* (2001: 47)

5.33 **There are some anomalies in freight charges, whereby freight transport to Johannesburg is more lucrative for operators than to other local destinations involving similar distances.** A large and growing trade deficit in favour of South Africa means that there is an imbalance of trade, pushing overall delivery prices up because trucks are returning empty and cannot make onward deliveries because of restrictive cabotage rules (see paragraph 5.35). Further, some supermarkets (such as Woolworth) use their own trucks, which carry only Woolworths products, almost all of which originate from South Africa. Some freight export shipments are delayed for a few days because the low volume of shipments from Botswana is often insufficient to occupy whole trucks, requiring goods to wait until they can be grouped.

5.34 **Reviews of the domestic road transport market suggest that there are no major policy restrictions to new entry among the commercially established operators with the exception of passenger transport (which are restricted to citizen-owned enterprises) and cabotage laws (see below)**. There are no equity limitations on existing or new market entrants for freight, special cargo, forwarding and cabotage; and government does not hold any equity stakes in the road transport business. It takes only one day to process a license for freight operations and a similar timeframe for a special cargo license.

5.35 **However, restrictive cabotage laws (common to all SADC countries) contribute to the high costs of transport in the region.** Cargo carriers are not allowed to pick up loads at the delivery destination, except those destined for their originating country. This means that they cannot pick up loads destined for a third country or elsewhere in the delivery country. For example, South African trucks delivering goods to Botswana cannot then pick up produce for delivery via Walvis Bay in Namibia, nor could returning foreign-registered trucks on the Trans-Kalahari route drop off imports to Botswana and pick up a load for shipment via Durban in South Africa. Freight charges in the westerly direction to Walvis Bay are reported to be about 3 times more than the easterly direction back to Botswana. This could have a strong impact on overall transport costs, since the majority of trucks carrying exports from Botswana are registered in South Africa. Regulatory reform has had a significant impact on prices in other countries – for example, liberalization of the transport market in France reduced transport costs by between 20-40 percent

5.36 **Road charging is a particularly contentious regional issue.** Botswana recently revised its road user charges for foreign-owned freight vehicles, with an increase of 797 percent in fees for the Tlokweng-Gaborone Section. According to government officials, this was done to equate Botswana road charges to the toll-road equivalents in South Africa, and was a cost-recovery measure, rather than a non-tariff barrier to protect the Botswana trucking industry. However, South African road tolls apply equally to foreign and domestic trucks. There is concern that South Africa may respond with similar tariffs on foreign trucks. The increase was made without consultation with SACU partners. This lack of consultation is not unique to Botswana. South Africa imposed a toll gate near the Tlokweng border without consultation. It has also started implementing strict registration requirements for foreign-owned vehicles, including those from SACU partners. These are issues that require greater intra-SACU coordination between transport ministries.

Table 5-6: Botswana Road User Charges

BOTSWANA ROAD USER CHARGES WITH EFFECT	AMENDMENT REGULATIONS 2004			AMENDMENT REGULATIONS 2000		
ROUTE	TLOKWENG-GABORONE (27km)	PIONEER GATE-MAMUNO (720km)		TLOKWENG-GABORONE (27km)	PIONEER GATE-MAMUNO (720km)	
TRIPS	SINGLE	ONE WAY	RETURN TRIP	SINGLE TRIP	ONE WAY	RETURN TRIP
ROAD USER CHARGE (BWP)		660.00	1200.00		640.00	128
ROAD USER CHARGE (USD)		137.50	250.00		133.33	26
ROAD USER CHARGE		19.10	17.00		18.52	
SADC PROPOSAL 4-5 AXLE		8.80	8.00		8.80	
SADC PROPOSAL >6 AXLE		12.20	12.00		12.20	

NOTES:
The 2004 fees assume that trucks will do ten trips per three month period and this assumption is used to calculate a single trip road user charge for the year 2000 fees, which do not stipulate single trip fees.
The road user charge in USD/100km has increased significantly from 25.66 to 204.48, i.e., by 797 percent, for the Tlokweng-Gaborone Section.
Source: Southern Africa Regional Competitiveness Hub.

5.37 **Botswana is a party to some preferential agreements in the road transport sector.** Other agreements are at a draft stage. Bilateral road transport agreements were initiated and concluded with Zambia and Zimbabwe during NDP8, with a view to facilitating an unimpeded flow of goods and passengers (*NDP9,* Para. 8.17).

Rail Infrastructure

5.38 **Botswana's railways consist of a single main line of 6,041 km.** There are three short branch lines. This links to South African railway to the South and Zimbabwean railway to the North East. The railway is maintained and operated by Botswana Railways which is a 100 percent Government owned parastatal. Freight traffic has been very volatile, with a generally downward trend in the last five years (World Bank, 2005). This is mainly because of increasing competition from road traffic, and because of the new Beit Bridge to Bulawayo rail link between South Africa and Zimbabwe – this link has made the rail journey between the two towns some 200 km shorter than the route via Botswana.

5.39 **The main export that relies on railway transport is soda-ash and raw materials for the apparel sector.** This uses the South African rail parastatal 'Spoornet' to transport soda ash to the South African market. Spoornet is a monopoly provider of rail services to Botswana's soda-ash industry. There have been ongoing concerns expressed that Spoornet has been extracting monopoly rents, possibly in the knowledge that it would be more profitable for them to transport soda-ash to South African customers from overseas suppliers. For the textile companies interviewed for this study, most brought raw materials into Botswana by rail and used road freight to dispatch finished goods. Freight companies still complain that railways are less reliable than road transport, giving inexact estimated delivery times with a 2 day variability. Trips to Durban from Gaborone take between 4 to 7 days, compared to 1-2 days by truck. Some businesses have complained about theft of cargo from trains while they were still in South Africa. Rail infrastructure has limited potential to serve as a catalyst for the country's tourism industry. It is limited to the route between Lobatse and Francistown and as such has limited potential for tourism use. The main modes of tourism transport are by road and air.

Access to Tourism Areas

5.40 **Access to many of the main tourism attractions is limited to gravel roads which are mostly only navigable by means of 4-wheel drive vehicles.** These include access roads to most of Botswana's national parks, all roads within the parks and reserves and many connecting roads between the main attractions, such as the road between Maun and Kasane.

5.41 The undeveloped road system has been applied as a control mechanism to limit access to conservation areas and to maintain the wilderness character of the destination. **However, this has largely limited Botswana's product range to packaged tours and trips and to the fully equipped self-drive 4-wheel drive journey.** The substantial increases in day visitors to the Chobe Park from Kasane, which can be reached by tarred road from Victoria Falls and Livingstone, provides an indication of the pent-up demand for access to the Park by the broader travel market that requires greater flexibility and wishes to include Botswana as part of a wider regional travel package. The proposed Kazungula bridge that will connect Botswana, Zambia and Zimbabwe through a singular access point could improve the attractiveness of a regional travel circuit.

5.42 **Given the need to spread Botswana's tourism appeal across a wider spectrum of market segments (in particular the self-drive market), the possibility of upgrading some of the gravel access roads to and within the parks should be investigated.** This could include, for example, roads from Maun to Moremi, between Chobe and Moremi and within particular zones of the parks. This would allow easier access for self-drive travellers. The potential impact of such road improvements should be thoroughly investigated and the appropriate roads should be selected with great care so as not to dilute the wilderness brand. Such upgrades should be accompanied by infrastructure improvements in the selected high density areas of the parks so as to accommodate increased visitor flows in a sustainable manner (see Box 3-1).

RECOMMENDATIONS - LAND TRANSPORTATION

- Undertake a review of the impacts of restrictive cabotage laws (common to all SADC countries) with a view to initiating a coordinated effort to liberalize these restrictions (paragraph 5.35).
- Government to review the road charges that were introduced in March 2004, with a view to reversing them, and fully consulting with other Member States before invoking any such charges in the future (paragraph 5.36).
- Government to encourage greater consultation among SACU Transport Ministries, possibly establishing a transport desk within SACU and encourage intra-SACU dialogue between transport authorities (paragraph 5.36).
- Botswana to take up Spoornet pricing issue within SACU, and to explore whether South African competition laws allow for consideration of rail pricing complaints by Botswana Ash (paragraph 5.38).
- Government to investigate the possibility of upgrading some of the gravel access roads to and within the parks – for example, from Maun to Moremi, between Chobe and Moremi and within particular zones of the parks. Such upgrades should be accompanied by infrastructure improvements in the selected high density areas of the parks so as to accommodate increased visitor flows in a sustainable manner (paragraph 5.42).

AIR TRANSPORT

5.43 **Passenger travel costs are high, which has an impact on tourism and exports of business and financial services.** A roundtrip standard economy class fare to Johannesburg increased from 766 Pula in 1996 to 1472 Pula in 2000 and 2158 Pula in 2004. This represented a 92 percent increase between 1996 and 2000, with a further 46 percent increase to 2004.

5.44 **Market access to the air transport sector is quite restrictive in comparison with road transport.** Restrictions exist, in particular for scheduled domestic air transport services and international air transport services. Air Botswana is Botswana's only designated scheduled airline, with the Botswana Government as sole shareholder. The skies over Botswana are managed through a series of bilateral agreements with countries which receive Air Botswana flights or whose airlines provide flights to Botswana. The bilateral agreement with South Africa has an important influence over air access, frequencies and prices to Botswana, as South Africa is the major entry point to the region for overseas visitors. Until recently this provided for a single designated airline of each country to fly between the two destinations and allowed a single entry point for each country. However, this agreement was adapted significantly in 2004 as follows:

- A phased approach would be followed towards an open-skies, multi-designated aviation regime over the next three years;

- Each country would be allowed three entry points, paving the way for Air Botswana to introduce the very important Cape Town-Maun Route, in addition to the Johannesburg-Gaborone Route.
- New routes to any destination in Botswana could be introduced from any point in South Africa other than Cape Town and Johannesburg;
- All restrictions to be lifted on seat capacity and cargo.

5.45 **The movement and agreement towards open skies should be welcomed and is of critical importance, in particular, to the successful expansion of the tourism industry and financial services industries.** Improved service levels, flight frequencies and price reductions will only become a reality when greater competition is allowed on air routes into Botswana.

5.46 **Cargo prices are (unlike passenger services) largely determined by market forces for international routes.** Air Botswana has a dedicated cargo service. Cargo increased from 259,910 Kg in 1995 to 524,979 Kg in 2000. Most of this cargo was imports. There is little demand for export of air cargo with Johannesburg airport less than a day's drive from the border with Botswana. South African airports do not have any cold room facilities, although this is not considered a constraint to exports from Botswana.

Box 5-3: Tourism and Air Transport

- An analysis of tourism price factors contained in the background study on tourism suggests that, while hospitality, communication, entertainment and entrance costs are largely market related, transportation is a large cost item that has a major influence on the cost of a holiday to Botswana. The high flight costs between South Africa and Botswana (on average around US$ 500 return with no internal transport costs or taxes included) add substantially to the overall cost of a visit as these costs are in addition to the overseas flight leg. The costs do not compare favourably to long distance internal flight costs in South Africa (e.g., average flight costs between Cape Town and Johannesburg are around R1500).
- Almost all of the tourist industry participants interviewed for the background study considered that Air Botswana's monopoly in Botswana's air transport, and what they saw as the resulting high air fares and limited availability, was a major constraint for tourism development.
- The successful diversification of tourism towards the lesser frequented tourism areas of the Central Kalahari, the Western Delta, the Pans and the Kgalagadi will be substantially enhanced through affordable and easy air access. The Botswana Government owns a large network of airfields located across the country and the improved utilization of these airstrips towards facilitating the spreading of visitors to lesser frequented areas should be investigated. The possibility of these airstrips being utilized as sub-stations for feeder routes from distribution hubs in Maun and Kasane could improve the fast and effective movement of tourists across the country. It would also tie in well with the proposals contained in the Tourism Development Framework and could provide flexible travel options for the independent traveller.
- While various private operators already offer charter flights from Maun to remote tourism locations, such as the Kalahari, these normally form part of fully inclusive packages and occur on a small, uncoordinated scale. The implementation of such an internal "hub and spoke" distribution strategy will require a well coordinated effort between the transport and parks authorities, so as to ensure that the parks and wildlife attractions are geared to receiving the increasing number of visitors. The potential role of Air Botswana as an internal tourism feeder airline from hubs such as Maun and Kasane to a variety of smaller airstrips across the country should also be investigated. It may be appropriate to launch a pilot program in association with private operators and Air Botswana to test the feasibility of such a system.

- Airports are vital links in the tourism value chain, but their success is dependent upon the synergy they achieve with other elements in the tourism value chain. The expansion of runways and airport facilities in towns such as Maun and Kasane will not be sustainable unless the national parks and conservation areas that provide the real reason for visitors to fly to these centres are improved and upgraded to accommodate the larger number of customers ferried in through the airports. However, large airplanes are a major source of noise and air pollution and proper environmental impact assessments should be conducted before final decisions are taken regarding the location and scope of expansions.

RECOMMENDATIONS - AIR TRANSPORT

- Progress made with the phased agreement towards open skies should be closely monitored, so as to ensure that it gets implemented within the agreed time frames, if not sooner (paragraph 5.45).
- Government to set a new target date for the privatization of Air Botswana (paragraph 5.44).

THE BUSINESS COSTS OF UTILITIES

5.47 **The state retains a monopoly in key utilities,** including fixed-line telecommunications, water supply and sewerage services, and electric power supply. It is beyond the scope of this study to set out detailed reform strategies for all utilities – a World Bank-PEEPA project is underway that attempts to assess reform strategies in more detail. However, this section sets out the costs of utilities that have the most impact on export industries.

5.48 **Table 5-7 provides some information in relation to neighbouring countries.** Botswana shows the highest costs for electricity, water and telecommunications, as well as sea freight.

Table 5-7: Comparative Cost of Infrastructure Services (US Dollars)

	Botswana	Kenya	Mauritius	Mozam-bique	Namibia	South Africa	Zim-babwe
Airfreight (per kg)	1.840	1.700	2.570	2.180	2.330	1.170	2.220
Sea freight to Europe (per 20-foot container)	2.000	1.400	1.800	1.500	1.080	1.000	2.000
Electricity (per kwh)	0.096	0.020	0.076	0.036	0.036	0.064	0.048
Water (per m3)	1.020	0.350	0.520	0.350	0.670	0.300	0.340
Telecom to EU (per minute)	4.040	4.000	1.650	3.600	1.230	2.210	2.580

Source: Namibian Investors, reproduced in UNCTAD (2002)

5.49 **Botswana does not provide utility subsidies as a matter of policy, although there are a number of cross-subsidies in the provision of goods or services.** These are made by parastatals or local level governmental organisations for poverty alleviation reasons (Imani, 2004):

- The Botswana Telecommunications Authority allows the Botswana Telecommunications Corporation to cross subsidise local calls by charging significantly higher than economic costs for international calls, although a separate budget line is being created plus a rebalancing of rates to reduce the cross subsidy.
- The Botswana Housing Corporation is allowed to charge higher rents to companies than to individuals and it largely only rents its houses and flats to citizen individuals.
- Following some years of cross-subsidy from urban power users to support the infrastructure costs of rural electrification, such work is now an explicit part of the government's budget. However, there is still an element of cross-subsidization in terms of administration costs and loans. Also, the Botswana Power Corporation has no off peak time rate for industrial or commercial users.
- Water Utilities Corporation has an entry level charge for residential water consumption that amounts to a subsidy and no billing advantage for larger commercial or industrial customers, where there are economies of scale.

5.50 **Part of the reason for high utility costs may be due to the country's geographic, geological and climatic conditions.** These factors affect, in particular, power, water supply and telecommunications. However, the existence of state monopolies in several services and managerial inefficiency may also contribute to high cost utilities. Reform options, such as privatization, may reduce the inefficiency associated with state monopolies. Steps have been taken to initiate privatization in areas where there exist statutory monopolies in order to improve competitive efficiency. However, the pace of progress towards privatization is slow, with concerns centred on ownership and control issues, rather than on improving national competitiveness. The use of low cost infrastructure from neighbouring countries may also have the potential to reduce the cost of infrastructure services like power and water. By locking into electricity grids and water supplies from neighbouring countries, rather than developing additional, high cost domestic facilities, it may be possible to contain costs.

Telecommunications

5.51 Telecommunications systems are reasonably reliable and are being upgraded - the main constraint is high call charges and poor internet infrastructure relative to Botswana's regional competitors. Botswana currently has some of the most expensive international call charges in the world (Table 5-8), while domestic calls are cheaper than South Africa and Namibia. Prices for different components of BTC's service do not reflect the relative costs of providing those services – prices of international calls are well above cost while prices of national calls and fixed charges for line rental and installation are below cost (World Bank, 2005).

Table 5-8: Regional comparison of Fixed line call charges as on 2004 (US$/minute)

	USA	UK	Norway	Switzerland
Botswana	1.06	1.06	1.19	1.06
Namibia	1.26	1.26	1.42	1.25
South Africa	0.25	0.25	0.61	.25

Source: BIDPA

5.52 **Internet user costs are quite high.** A high speed ISDN connection in Botswana costs about ten times as much as an ASDL connection in Mauritius and about eight times that of an ASDL connection in South Africa[39]. Botswana's competitors in this field, such as India, Mauritius and South Africa, are all connected to international backbones. Botswana's IT infrastructure is not sufficient for applications that would require high amount of data transfer. The Government is currently considering options to connect to undersea cables either in Indian Ocean or in Atlantic Ocean. This is an expensive proposition and it would involve other countries. It appears that a western connection seems to be the preferred one.

5.53 **Impacts of high international telecommunications costs vary between export industries.** For manufacturing, the cost of telephone calls is not a major input; although, because of the extent to which the internet has transformed the way business is done, Botswana manufacturers will need to install new technologies, especially internet based facilities for receiving and sending orders and tracking down the location of the orders. For service sectors such as consultancy, tourism and financial services, this is a more significant cost item. Limited bandwidth and, hence, internet speed remains a constraint, particularly for ICT companies. For example, outgoing call costs are the major business expense (alongside salaries and training) for a recently-established call centre sourcing UK Independent Financial Advisers.

5.54 **The Botswana Telecommunications Corporation (BTC) has a monopoly in the provision of international infrastructure used for voice and all international voice services at the retail and wholesale level.** Mobile phone operations pay BTC around 90% of the retail price for delivery of outbound international calls (Ovum, 2004). There have been ongoing service problems with congestion on both inbound and outbound services. The retail prices of BTC, and the wholesale prices it charges to mobile operators are significantly higher than costs. Further, to protect the BTC monopoly, Voice-Over Internet Protocol (VOIP) is prohibited, thus limiting the development of cheap internet-based call services.

5.55 **Telecoms liberalization would reduce prices.** It would increase competition to BTC in the supply of fixed network services through increased voice and Internet access using fixed wireless access in Gaborone and other substantial towns. There would also be greater competition in the supply of international voice services between the three existing operators, any new fixed wireless access operators which enter the markets and existing internet service providers offering VOIP services. Ovum (2004) concluded that allowing

[39] DSL services are currently not offered in Botswana. Comparisons are made with ISDN vs. DSLs with approximately similar data transfer speeds. Cost figures were taken from an Accenture study on the feasibility of establishing call centres in Botswana (unpublished).

data licensees to provide VOIP services would have a major impact on reducing international telecoms prices in the Botswana market.

5.56 **Some telecoms upgrading is underway - Government has invested in a substantial technical upgrading, and is now focusing on international connectivity.** BTC is in the process of substantially upgrading its international facilities with a high capacity fibre link to London via Cape Town, and fibre access to the East African Sea Cable via one of three possible routes. This will also reassess the balance between domestic and international call charges, while removing rural-urban cross-subsidies from the pricing structure by making rural subsidies an explicit part of the government telecoms budget. Efforts to rebalance these charges should be accelerated and implemented. The debate to allow a second operator is at an advanced stage. The Botswana Telecommunications Authority should also start considering the entry of a third Cellular telephone operator. The Government has announced its intentions to privatize the Botswana Telecoms monopoly, although no target date has been set.

Electricity

5.57 **Power costs are about the regional average, although are more than double that of South Africa.** The majority of Botswana's consumption of electric power is purchased from South Africa, with about 28 percent being produced locally. The calculation of tariffs also has impacts on production costs in other sectors, such as textiles and garments. The average tariff in BWP terms demonstrates that it has risen at a lower rate than inflation for the whole period from 2000 to 2003 – this is in line with current government policy to keep electricity price increases at less than 50 percent of inflation rates (World Bank, 2005). In fact, a review of the average monthly bill for seven regional power companies for commercial customers (World Bank, 2005) suggests that Botswana has the second lowest tariffs for commercial consumers in the region, only after Zambia's Zesco (Table 5-9).

Table 5-9: Comparison of average tariffs (FY2002)

Country	**Power Company**	**Average tariff (US$/kWh)**	**Operating Cost Recovery Ratio**
Angola	Empresa Nacional de Electricidade	0.012	
South Africa	ESKOM	0.017	
Swaziland	Swaziland Electricity Board	0.038	123%
Botswana	BPC	0.040	154%
Malawi	ESCOM	0.056	162%
Mozambique	Electricidade de Moçambique	0.066	
Kenya	Kenya Power & Lighting Co.	0.068	96%
Uganda	Uganda Electricity Distribution Co Ltd	0.091	112%

Source: Audited financial statements of each utility **(World Bank, 2005)**
Operating cost recovery ratio is calculated as operating revenues divided by operating costs (exclusive of depreciation).

5.58 The Botswana Power Corporation (BPC) is the service provider. **BPC claims that it is quite capable of supplying the requirements of the country's industries and future growth.** Botswana has a better track record in stability of supply than many other countries in the region, although over half the textile and garments manufacturers interviewed for this study reported frequent electric supply interruptions, particularly during the rainy season. A survey of textile producers (BEDIA, 2003) quoted a number of complaints that companies continued to be charged at the maximum higher rate tariff appropriate to higher demand even when they had reverted back to a lower usage level. Botswana Power Corporation charges very high rates to install electrical lines, despite the fact that developers and investors could do it at less cost (FIAS, 2003).

Water

5.59 **Water costs for manufacturers have increased significantly in recent years.** Botswana's arid climate and geographical position mean that water is scarce and expensive. The average water tariff is well above other water utilities in the region (Table 5-11), and has risen considerably faster. Tariffs have risen at a faster pace than inflation for the whole period from 1999 to 2004 (World Bank, 2005). The following table reproduced from BEDIA (2003) shows how the unit cost of water in Gaborone and Francistown increased by over 60 percent over the 3-year period from September 1999 to September 2002:

Table 5-10: Internal Water Usage and Cost (Botswana Pula, Unit cost)

Reference Period	Consumption Month (m3)	Gabo-rone	Jwaneng	F/Town	Sua	Selebi-Phikwe
Sept 99 / Aug 00	25+	6.92	3.67	5.03	6.00	4.43
Sept 00 / Mar 01	25+	7.75	3.95	5.65	4.75	3.40
Sept 02- to-date	25+	11.30	4.95	8.25	6.00	4.30
Percent Change		63	35	64	0	0

Source: Botswana Water Utilities Corporation

Table 5-11: Comparison of average tariffs (FY2002)

Country	Water Utility	Average tariff (US$/m3)	Operating Cost Recovery Ratio
Botswana	Water Utilities Corporation	1.21	261%
Malawi	Lilongwe Water Board	0.37	142%
Malawi	Blantyre Water Board	0.54	145%
Swaziland	Swaziland Water Services	0.65	120%
Uganda	National Water and Sewerage Co.	0.55	126%

Source: audited financial statements of each utility.
Operating cost recovery ratio is calculated as operating revenues divided by operating costs (exclusive of depreciation). Figures for LWB are for FY2001.

Table 5-12: Regional Water Cost Comparison

Country	Ranking 0.1=best 2.3 worst	Cost – US$ / Metre3
South Africa	0.1	$0.25 to 0.37
Swaziland	0.3	$0.50 to 0.75
Namibia	0.3	$0.63
Mauritius	0.6	50 percent of cost
Zimbabwe	0.8	No data
Mozambique	1.0	No data
Botswana	**1.0**	**$0.5 – 0.74 – 1.12***
Zambia	1.0	No data
Malawi	1.1	No data
Tanzania	1.6	No data
Lesotho	2.3	$0.42

Source: SADC Study 2001
* 0.5 – 0.74 – 1.12 –Selebi-Phikwe – Lobatse – Gaborone.

5.60 **Water is an important component in textiles and apparel production.** Industrialists requesting untreated water will generally have to pay for the reticulation of that water, the cost of which could be prohibitive. For textiles and garments, water costs are a major constraint by companies that use water in the dyeing process. Existing manufacturers dyeing fabric and yarn report major difficulties and/or expenses in getting access to inexpensive untreated water. The supply of raw water to the industrial estates for use in dyeing and washing would be of considerable advantage to industry. BEDIA (2003) quotes one garment manufacturer paying P8.20 /m^3 for water in 2003 compared to P4.50 / m^3 in Mauritius (this included a charge of P0.50 /m^3 for wastewater treatment). Tariff structures are again of importance in terms of incentivising production. BEDIA (2003) quotes concerns that the cost of water per cubic metre increases as usage increases.

5.61 **Water is supplied by the Water Utilities Corporation, which functions on a commercial basis, supplying water to all major urban and industrial areas.** The water connection rates for urban water compare very favourably with neighbouring countries (World Bank, 2005). The Corporation is confident that they had sufficient water resources at their disposal to supply Botswana's requirements without disruption. However, Botswana is still vulnerable to droughts and possibly longer-term threats associated with global warming. At the time of writing, the Gaborone dam – the main source of water for Gaborone- was less than 30 percent full because of poor rains. As an emergency measure, water restrictions were in place. World Bank and PEEPA (2005) make a number of recommendations to simplify and rationalise the institutional arrangements for the water and sanitation sector.

RECOMMENDATIONS - THE BUSINESS COSTS OF UTILITIES

- Revitalize the privatization program – particularly in the area of telecoms and air transport (paragraph 5.50).

- To reduce international telecommunications prices, Government should consider instructing BTA to issue an unlimited number of licenses for international voice services and lift the ban on providing voice over IP. The monopoly of BTC should not be allowed to continue indefinitely to allow BTC to restructure. Government should set a target date for the privatization of BTC (paragraph 5.53).

- The Government should encourage the Water Utilities Corporation to supply raw water to the industrial estates where textile and apparel manufacturers are located. This would be an enormous incentive to potential investors in weaving, knitting and dyeing plants (paragraph 5.60).

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