

# Botswana's Financial Assistance Policy and the Indigenization of Industrial Employment

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### **Abstract**

Botswana's efforts to industrialize take place against a backdrop of substantial dependence on foreign capital and labor. In this paper we examine the extent to which Botswana's economic dependence on South Africa have influenced the strategy of importsubstitution industrialization and the promotion of indigenous employment opportunities. We focus in particular on Botswana's Financial Assistance Policy as an instrument of industrial policy in pursuit of these twin objectives.

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## 1. Introduction

Botswana's recent industrialization experience offers an interesting case study for, *inter alia*, the five following reasons. First, while most African countries experienced various degrees of deindustrialization in the 1980s (Stein, 1992; Moseley, 1992; Steel and Evans, 1984), Botswana's real manufacturing value-added grew rapidly, at a rate fairly comparable to that for Singapore (World Bank, 1991; Lewis, Harvey, and Sharpley, 1990; Riddell, 1990a).

Second, while many less developed countries (LDCs), particularly African countries have shown strong tendencies to set up parastatals, nationalize foreign-owned enterprises, and/or to control private sector activities (Wilson, 1990), Botswana has continued to rely on, and actively encourage and promote, private enterprise of all forms of ownership: citizen, foreign, and jointowned.

Third, Botswana has been able to pursue an import substitution industrial development strategy without setting up a protectionist regime or exchange control mechanism, though such a strategy is generally viewed as particularly difficult for a small country to successfully capitalize on (Hughes, 1984)<sup>1</sup>. Fourth, Botswana was able to significantly increase citizen participation in the manufacturing subsector in both the areas of manufacturing employment and ownership of productive assets. Fifth, and finally, all of the above were achieved in spite of Botswana's close proximity to the Republic of South Africa (RSA) -- a large dominant, manufacturing country willing to aggressively pursue strong, and often fierce and predatory, competition against its smaller neighbors, in attempt to continue their subordination and perpetuate their political and economic dependency. Botswana's membership in the Southern African Customs Union (SACU), along with the RSA, Swaziland and Lesotho, limited the extent, form, and duration of public sector industrial intervention<sup>2</sup>.

Much of Botswana's success in the industrial sphere is attributable to an innovative financial support program, which since its introduction in 1982 has been the cornerstone of the government's industrial policy: the Financial Assistance Policy (FAP). Yet, most

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<sup>1</sup> In the late-1970s through mid-1980s period, the sources of Botswana's manufacturing growth have been primarily balanced between the rise in domestic demand and import substitution, with export growth playing a minor role (Lewis, Harvey and Sharpley, 1990; Riddell, 1990a).

<sup>2</sup> See Leith (1992) for a theoretical discussion the net benefits of the present custom union arrangement to Botswana.

analysts of the Botswana industrialization experience have ignore or down-played the importance of FAP's contribution to industrial growth<sup>3</sup>.

This paper aims to examine the role of FAP in the industrial development of Botswana for the purpose of: (a) determining the extent to which FAP played a positive role in Botswana's industrialization process by providing an appropriate incentive structure; and (b) to consider the limitations of reliance on financial incentives in promoting the deepening of manufacturing<sup>4</sup>. The analysis in this paper is primarily restricted to medium- and large-scale FAP-funded manufacturing projects.

## **2. Economic Background and Overview**

Botswana is a small land-locked country with a population of roughly 1.3 million, in an area the size of Texas or France, situated in southern African, juxtaposed to the RSA to the south. The country is semi-arid, with the Kalahari Desert occupying a much of its western and central regions. Most of the population reside along the eastern corridor of the country where the rainfall is less irregular and the soil is more fertile, or more correctly, less sandy or stony.

At independence in 1966, Botswana was one of the poorest and least developed countries of the world, with a per capita gross domestic product (GDP) of \$80 (at constant 1985-86 prices). The country had an agricultural-based economy, where livestock outnumbered people four to one. Meat and meat products accounted for an estimated 95% of the total manufacturing value-added and was the major foreign-exchange earner. The major non-government employer was the Botswana Meat Commission (BMC), a parastatal enterprise with a monopoly position in the beef processing and export market.

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<sup>3</sup> Several recent studies (Lewis, Harvey, and Sharpley, 1990; Harvey and Lewis, 1990; Riddell, 1990a; UNIDO, 1987) have presented overviews of Botswana's industrial structure, its sources of growth and prospects for future growth, and government industrial policy. These studies credit Botswana's industrial accomplishments to strong macroeconomic management, appropriate macroeconomic policy, market-orientation policies, exchange rate policy, and favorable balance of payment and foreign exchange position. However, all of these studies make only passing reference to the Financial Assistance Policy (FAP), the government's direct financial assistance program for private productive enterprise development which was the cornerstone of the government's industrial policy. The major exception to the about is the research by Kaplinsky (1991).

<sup>4</sup> See Riddell (1990b: p. 6 and endnote 20) for discussion of the concept of deepening of manufacturing and industry.

Yet, against almost overwhelming odds, Botswana's economic and social achievements have been phenomenal. Botswana's fortunes changed considerably with the discovery and exploitation of significant mineral deposits and due to the skillful management of the resulting revenue<sup>5</sup>. Botswana was transformed from a country which required financial support to carry-out the normal functions of government to a country with significant budgetary surpluses and large foreign exchange reserves. The country's total international reserves increased steady over the years from nil in the early 1970s to P131.3 million at the beginning of 1979; to P457.2 million at the end of 1983; to P1,644.5 million at the end of 1985; to P4,370.5 million in 1988, to P6300.0 million in 1990 (Republic of Botswana, 1992)<sup>6</sup>.

With the rapid and sustained economic growth which has been experienced over the period of mineral-led growth, the economic realities of the country have changed dramatically. Over the 1965-89 period, Botswana's economic growth record is unsurpassed, with real GDP growth rate averaging roughly 13% per annum. Albeit starting from a lower economic-base Botswana's economic growth rate over the last quarter of a century exceeds that of all the East Asia NICs (World Bank, 1991; Republic of Botswana, 1991). This economic performance resulted in real GDP per capita increasing eight-fold over the 1966 level (Republic of Botswana, 1992). Botswana moved from the ranks of the low income countries to the middle income countries, with per capita GDP at current prices being comparable to those of Brazil, Malaysia, and the RSA (Republic of Botswana, 1991; World Bank, 1991).

The heavy reliance on mineral production and revenues for growth left the Botswana economy quite vulnerable to the vagaries of international market fluctuations. With

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<sup>5</sup> In 1971 De Beers began to mine the first diamond pipe at Orapa. Also in that year, copper-nickel mining at the Selebi-Phikwe complex came on stream. Subsequently, came the discovery and development of new diamond pipes at and near Orapa (in 1975 and 1976) and the commencement of production at Jwaneng (in 1982), the world's largest known diamond pipe at the time.

<sup>6</sup> Botswana's national currency is the pula (P). In December 1990 one pula (P1) was equal to roughly \$0.53 (U.S. dollars). On the subject of foreign-ownership, UNIDO writes: Botswana's economy has always been strongly influenced by South Africa. Although no reliable statistical data shows the ownership of the manufacturing sector at independence, it is quite certain that the sector was predominantly owned and operated by foreigners. Later, several factors have made a rapid indigenization difficult: government's reluctance to use nationalization and government ownership as an instrument in the indigenization of industry; the scarcity of Botswana with a business education; and the high government demand for educated manpower. It is only recently that a significant number of Botswana has started formal sector businesses, and the trade sector is still far more popular for local business initiatives than manufacturing (1987: 26).

minerals, basically diamonds, accounting for about 45% of GDP and over 80% of export earning in the early 1980s (Harvey and Lewis, 1990; Republic of Botswana, 1991), this point was brought home very clearly when the domestic economy was adversely albeit temporarily affected by the world recession of 1981-82. The government set out to utilize mineral revenues in a way that would facilitate overall economic development and to diversify the economy away from dependence on mineral rents, as well as away from cattle and arable rainfed agriculture.

In order for the diversification and risk reduction strategy to succeed, the government would have to encourage economic units to diversify away from traditional (more familiar) productive activity and resource uses towards newer, less familiar and riskier activities and techniques of production. In an economy such as Botswana where the indigenous population is geared towards minimizing and spreading risk, for purposes of downside protection from adverse climatic conditions (Valentine, 1993), persuading the population to make a shift towards sustainable nontraditional activity is no small task. It requires a major and innovative effort.

Initially the Botswana economy was heavily reliant upon attracting foreign investment for the purpose of raising domestic production and employment expansion. As Botswana began its period of rapid economic growth, the view began to spread within the government and among the general citizenry that the manufacturing subsector was excessively dependent on foreign investment<sup>7</sup>. The government was concerned that the benefits of economic growth would accrue primarily to foreign-owned firms, expatriate managers and skilled manpower, and a few citizens possessing productive assets. It was feared that the resulting intersectoral and intrasectoral income inequalities would create severe social and political strains in the Botswana society where strong emphasis is placed on social justice. This created a risk that the government would be persuaded at some point in the future to pursue the interest of key pressure groups by moving to control, restrict, or somehow inhibit the foreign ownership of manufacturing enterprises<sup>8</sup>.

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<sup>7</sup> UNIDO (1987: 26) goes on to report that in 1984, excluding the BMC, foreign firms constituted 50% of manufacturing output, 51% of manufacturing value-added, and 41% of the total wage bill. Lewis, Sharpley, and Harvey (1990: 73) write that data suggest that in 1984 over 60% of all manufacturing establishments were wholly foreign-owned.

<sup>8</sup> Wilson (1990) theorizes that in circumstances like those of Botswana, where the entrepreneurial tradition is weak and there is the absence of a strong indigenous entrepreneurial class to exert its influence on state industrial and commercial policies, there is a strong tendency toward nationalization, the proliferation of parastatals, and/or state control of private sector activity.

In addition, throughout the 1970s and early 1980s formal sector employment (FSE) had not kept pace with overall economic growth; neither mining or agriculture (cattle or rainfed arable) had significant employment potential. With the exception of the financial subsector and those subsectors that were directly responsive to government expenditures on infrastructure, private sector activity (particularly among citizens) remained fairly sluggish; unemployment and underemployment levels remained markedly high.

Concerns about sluggish employment growth and lack of citizen participation in nonagricultural productive activity, led to the forming of a presidential commission to investigate constraints on citizen economic participation, the Presidential Commission on Economic Opportunities (Republic of Botswana, 1982).

Among the constraints identified to be inhibiting the development of productive enterprises and FSE in Botswana were the following (Republic of Botswana, 1982; Smith et al., 1988):

- (a) Lack of access to financial and working capital for small- and medium-scale productive enterprises owned by citizens;
- (b) Lack of industrial experience, with resulting lack of labor and management skills;
- (c) Lack of exposure to FSE and low labor productivity of low skilled, unskilled, labor;
- (d) Small size of the local market, obliging export in order to achieve economies of scale;
- (e) Need for, and high cost of maintaining, expatriate technical and managerial staff for most medium- and large-scale enterprises;
- (f) Strong, and often fierce and predatory, competition from RSA to supply the local market; and
- (g) The ever present instability emanating from its powerful RSA neighbor -stemming from the possibility of destabilizing activity, and from the increased uncertainty of the continuing volatility of the RSA internal domestic situation.

The commission recommended and the government accepted proposals which led to the institution of FAP<sup>9</sup>. With the introduction of FAP in March 1982, the Botswana

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<sup>9</sup> Actually work towards the introduction of FAP had already been well underway (see Ministry of Finance and Development Planning, 1981). The recommendations of the commission took into consideration the

government embarked on a rather innovative industrialization, diversification, entrepreneurial development, and employment program. FAP-scheme support was expected to serve two major purpose. First was to assist in overcoming the finance related constraints on productive enterprises development by providing equity finances were commercial financial institutions fail to due so. Second was to assist in improving the profit-risk tradeoffs, giving rise to productive enterprises in general and citizen-owned enterprises in particular<sup>10</sup>.

### **3. An Overview of the Financial Assistance Plan in Botswana**

#### **3.1 FAP Objectives**

Given the low level of household savings, the dominance cattle as the major form of holding assets and accumulating wealth in the indigenous economy, and the low rate of formal lending to citizens by financial institutions, the development of equity finance for manufacturing and for other sectors of the economy was seen as essential to increasing citizen participation in productive and diversified activities. Briefly put, the purpose of FAP was to facilitate the development of new productive enterprises and the expansion of existing productive enterprises with the purpose of creating employment for citizens (particularly for unskilled labor) and assisting in diversifying the economy which is overly dependent on the mining and cattle sectors. A major emphasis here is on expanding the productive economic opportunities in rural areas and strengthening the entrepreneurial capacity of citizens. The policy is designed to achieve these goals in an economically efficient, cost-effective, and sustainable manner.

The advent of FAP was to assist in providing equity finances for private productive enterprise development. There was, of course, no overall shortage either of credit or of foreign exchange for industry in Botswana: the availability of over two years' imports in the foreign exchange reserves and the commercial banks were so liquid that the Bank of Botswana (the central bank) had to act as deposit taker of last resort. However, there were some gaps in the type of finance available. The commercial banks were effective in supplying short-term working capital, but very slow to supply long term finance or to act as agents in obtaining other types of finance for borrowers (Harvey, 1988; Republic of Botswana, 1991).

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background work on FAP. The expression of urgency to set up a credit subsidy scheme to promote productive enterprises assisted in expediting the introduction of the policy.

<sup>10</sup> See Felix (1989) and Anderson and Khambata (1985) for discussion on the profit-risk tradeoff in LDCs and how government policies may affect this trade-off.



While Botswana's excess liquidity phenomenon (and the corresponding situation of large government surpluses) is quite distinctive among LDCs, it should be realized that many structural features of Botswana's financial system were symptomatic of countries at its level of development, and were not peculiar to Botswana. Despite high liquidity, access of citizens to formal credit was limited by a combination of factors. First was the conservative procedures of the banks. With the low degree of competitiveness, there were (then) only two banks, the banks did not have to be particularly entrepreneurial to earn high rates of profits.

As was the case in the past for British commercial banking, banks in Botswana emphasized overdraft facilities and did not offer much in the way of longer-term resources to fund investment at least in the case of Botswana entrepreneurs (World Bank, 1989). Second was the low level of understanding of commercial practice, accounting and record-keeping among potential citizen entrepreneurs<sup>11</sup>. And third was the lack of experience among citizens in identifying profitable opportunities, developing workable business plans, and convincing the banks (who were staffed at the management levels by expatriates who were not use to working with indigenous entrepreneurs) that their projects had reasonable chances of turning profits.

The government through its industrial policy attempted to use the economic rent extracted from the mineral sector to encourage the development and expansion of directly productive enterprises that would not require long-term public subsidies<sup>12</sup>. FAP was to become the cornerstone of this policy.

FAP's major strategy was to use public direct financial assistance to aid in improving the profit-risk tradeoffs. This was to be accomplished in a way that would not induce inefficiency or generate enterprises that would require long-term subsidies. The government's aim was to reinforce reliance on basic market activity, correct market failures, not to supplant market forces.

Since its inception FAP has constituted a major part of the efforts by the Botswana government to diversify the economy, promote citizen entrepreneurship, and to create

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<sup>11</sup> These constraints are not uncommon throughout the developing world. See Elkan (1988), Schmitz (1982), and Dennis and Khambata (1985) for discussion of the general financial constraint and lending practices in LDCs.

<sup>12</sup> The term "productive" here implies the production of a physical product. Large scale mining, cattle-rearing, and traditional agricultural is excluded, inasmuch of the governmentpolicy objective is to diversify the economy away from these activities. All services have been excluded, although considerations are now underway to support services that directly impact upon production in "productive" enterprises.

productive employment. FAP seeks to contribute to these main aims by channelling financial assistance in the form of grants to new productive business activities and expansion of existing productive activities within manufacturing, non-cattle agriculture and small-scale mining sectors<sup>13</sup>. Only activities that produce physical products are considered for funding<sup>14</sup>.

In precise terms, objectives of the FAP are:

- (1) To facilitate rapid industrialization;
- (2) To assist in diversifying the economy away from dependence on large-scale mining and noncattle and nontraditional agricultural projects;
- (3) To assist in diversifying the economy across regions, away from the major urban and periurban areas, and promote rural industrialization;
- (4) To promote sustained employment of unskilled labor and assist in addressing Botswana's employment problem<sup>15</sup>;
- (5) To promote the acquisition and upgrading of the skills of Botswana citizens through training; and
- (6) To assist in the promotion of citizen participation in the ownership of productive assets.

FAP-support partially socializes private risks and the subsequent improvement in the profit-risk tradeoff in attempt to raise the rate of industrial investment and to favor the growth of the citizen entrepreneurs relative to foreign investors. Raising investment can be achieved by improving the profit rate thereby promoting faster growth of the national industrial entrepreneurship, by changing the indigenous-foreign composition and the risk variance, without over interference in the operation of the market (Anderson and Khambata, 1985; Felix, 1989).

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<sup>13</sup> It should be noted here that while FAP covers manufacturing and some agricultural activities, I limit my analysis to support for manufacturing activities only, in line with the focus of the present paper.

<sup>14</sup> Whereas it was originally anticipated that linking services, i.e. those services that would enhance and facilitate productive activities, would be covered under FAP, to date there has been no agreement as to what set would constitute interlinking services.

<sup>15</sup> The definition of what constitutes unskilled labor is tied to wages scale in the central government for lower skilled/unskilled manual workers, the government industrial class. The cut-off point used is the first notch of Group 1 for the industrial class scale. Workers at FAP recipient enterprises making this amount or below are considered unskilled for the purpose of capital grant, labor grant, and training grants. Once a worker's pay rises above this amount, that worker ceases to be considered unskilled. It should be noted that this scale is about one-third higher than the legal minimum wage for workers in the private industrial sector.

### 3.2 FAP Operations

The methods of determining the amount of assistance vary according to the size of the enterprise under consideration. All assistance, though, is provided in the form of non-repayable grants. The justification of any assistance and its extent under FAP is based on an assessment of the overall merits. Projects are divided into three categories for the purpose of review and administrative procedure: large-scale enterprises (LSEs), with fixed capital over P1 million; medium-scale enterprises (MSEs), with fixed capital between P25,000 and P1 million; and small-scale enterprises (SSEs), with fixed capital less than P25,000, and whose participants are limited to wholly owned citizen-enterprises. The focus of this paper is the first two.

The total FAP assistance-package is comprised of five components: (a) a (pre-production) capital grant; (b) a (production period) labor (employment) grant; (c) a training grant; (d) a sales augmentation grant to support economically productive activities, and where appropriate in the case of exports; and (e) tax-holiday grants.

Capital grants are equal to P1,000 or P1,500 per unskilled citizen expected to be employed in production-work depending on whether the recipient enterprise is foreign, joint or wholly citizen-owned, with the latter enterprise receiving a large grant<sup>16</sup>. Capital grants are calculated in relation to the projections of unskilled labor requirements. Labor grants provide reimbursement for recipient enterprises on a step-down basis: at 80% of wage bill for unskilled production workers in year-one and year-two; 60% in year-three; 40% in year-four; and 20% in year five.

Labor grants are provided on an ongoing basis in relation to the number of production workers that were actually employed in the preceding quarter. Training grants provide reimbursements of 50% of the off-the-job training costs incurred at recognized training institutions during the five years of FAP coverage. On-the-job training costs are not covered, regardless of whether they were incurred in the act of production or during in-house training sessions. Training grants had an upper limit of P2500 per trainee per annum. Sales augmentation grants are equal to a part of the export sales revenues over the five-year period of FAP. The object is to provide an export incentive, to encourage enterprises to expand their scale of operation, taking advantage of the cost-reducing potentials of economies of scale, to compete within the non-SACU market. This is a

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<sup>16</sup> Initially no distinction was made between citizen and foreign investors with respect to the size of grants. This changed in 1988 after the government accepted recommendations proposed in the second FAP evaluation (Republic of Botswana, 1988).

step-down grant of 8% of export sales in year-one and year-two; 6% in year-three; 4% in year-four; and 2% in year-five.

Tax holidays consist of tax reimbursements for five years on a step-down basis of: 100% in year-one and year-two; 75% in year-three; 50% in year-four; and 25% in year-five. In addition, there was a location factor built into the determination of grants depending upon enterprise-location. The country was divided into five zones for the purpose of grant calculation, with the amount of grant components and the maximum allowable grant varying across locational zones. The six locational zones were: urban areas; peri-urban areas; non-urban primary centers; rural area east, comprising rural locations in the eastern corridor (up to 100 km west of the line of rail) where the bulk of the population resides; and rural area west, comprising the remainder of the rural economy, which is more remote, lacking in physical infrastructure and transport and commercial networks.

The main principles guiding the allocation of grants are as follows. First, there should be reasonable expectation that benefits in terms of new incomes and jobs created would outweigh the cost of assistance. Second, assistance should be temporary. The recipient enterprise should have a reasonable chance of operating profitably after FAP-assistance is phased out. And third, assistance should be given in ways which would encourage investors to make business decisions benefiting national development objectives like employment creation for lowskilled/unskilled citizens and diversifying production across regions.

With regard to the first, a limit was placed on assistance equal to 50% of domestic value-added and the project was expected to yield at least a minimum 6% rate of economic return to Botswana over the five-year FAP-cycle. For the purpose of FAP value-added is defined as sales revenue minus tradable inputs minus non-citizen wages and salary payments. In the case of the second, in an attempt to avoid having FAP funded enterprises becoming permanently reliant upon public support assistance is provided for a five-year period, with the grants being phased out on a step-down basis, to assist the enterprise through its "teething" period. Finally, assistance was to be related to the various objectives. Capital grants were provided, assisting the enterprise in getting established, and increased the tendency towards greater capitalintensity. However, this tendency was tempered by the fact that the amount of assistance was tied to the number of production workers employed.

There is a maximum limit placed on the proportion of total fixed investment costs to be funded through FAP grants, depending on the locational factor. Also, some types of assistance differed depending on which locational zone the production was to take place. The further away from the major urban areas, particularly Gaborone and Francistown, the greater the assistance.

The capital grant assists entrepreneurs in overcoming the financial impediment to starting and expanding productive enterprises. Capital grants are provided up-front, to assist the entrepreneur in covering total fixed investment costs required before the production can get underway. In Botswana, as in many other LDCs, potential entrepreneurs have the propensity to possess higher aversions to risk and lower saving propensities than do foreign investors. To advance the objective of providing preferential assistance to indigenous entrepreneurs greater per employee grants are provided to citizen than to foreign investors.

Labor grants are provided under the assumption that citizen labor, as first or second generation wage employees, most of whom are coming from a rural primarily self-employment crop and livestock agricultural background, is unfamiliar with the rigors of FSE and possess low productivity. In the Botswana case, building a stable, productive and discipline manufacturing workforce requires a wage higher than the prevailing market wage for unskilled labor. FAP facilitates the payment of such a wage.

The differential between the wages paid by most FAP recipient enterprises for unskilled production workers and the market wage rate for unskilled labor may be viewed as an required investment in building the desired workforce, providing what Jedruszek (1978) calls "motivational capital"<sup>17</sup>. The government, through FAP, is willing to subsidize this investment in "motivational capital", operating under the assumption that similar to the step-down function by which the labor subsidy is phased out, over time labor productivity is expected to rise to equal marginal labor cost (with wages as a proxy).

Training grants are provided to help facilitate the upgrading of citizen's skills. Skill acquisition is recognized as being important for improving productive efficiency and reducing dependence on expatriate skilled manpower. As on-the-job training costs are hard to quantify and document, there is the question of production versus training in such

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<sup>17</sup> In some sense Jedruszek's "motivational capital" is similar to the concept of an efficiency wage. See Shapiro and Taylor (1990) and Mazumdar (1989) for discussions of the application of the efficiency wage concept to state support for industrial development.

costs, only off-the-job training costs are covered. Even then, these costs are covered when the recipient enterprises sends its production workers to recognized training institutions, such as a vocational training center or a technical school.

The FAP is administered by the Ministry of Finance and Development, and its resources are managed by a specially created public fund called the Productive Employment Development Fund (PEDF). In the 1990-91 fiscal year alone, about P40 million was committed to the FAP.

All LSE and MSE projects are reviewed by a technical committee comprised of representatives from the: Ministries of Finance and Development Planning, Commerce and Industry, Agriculture, and Mineral Resources and Water Affairs; Bank of Botswana (the central bank); the National Development Bank (NDB); and the Botswana Development Corporation (BDC). LSE projects are further reviewed by a high-level development committee comprised of top officials from the same organizations.

The NDB and BDC are represented not only for their expertise on private sector development and enterprise matters, but also because funded projects may require loans and/or additional equity capital beyond the owner's equity and FAP support. Further to this, projects appraised for FAP-funding may be currently under review or have already been considered by these organizations.

With respect to both the LSE and MSE categories two different FAP assistance-packages are available: automatic financial assistance (AFA) and case-by-case financial assistance (CFA). AFA, as the name implies, is automatically given to new and expanding enterprises and the grants are in the form of reimbursements rather than funds for initial investments. AFA support consist of three grant components: labor grants; training grants; and tax holidays. No pre-production, capital grants or sales augmentation grants are provided, as AFA projects are generally large multinational enterprises with their own funding sources and whose markets are expected to extend beyond Botswana's borders.

Approval conditions for CFA projects are more stringent. These projects must satisfy the criterion of the minimum 6% economic rate of return. CFA support consist of all grant components available (capital, labor, training and sales augmentation grants), with the exception of the tax holiday.

#### 4. FAP Successes

##### 4.1 The Record of Established Enterprises in Terms of Economic Diversification

In the 1980s, the manufacturing subsector showed considerable strength and resilience despite the adverse effects of the devastating six-year (1982-88) drought on the beef industry"<sup>18</sup>. Between 1979-80 and 1989-90 the manufacturing subsector grew by at 5.3%, yielding the highest growth rate of manufacturing value-added in Sub-Saharan Africa, which was fairly comparable to the growth of the same subsector in Singapore at 5.9% (World Bank, 1991; Lewis, Harvey, and Sharpley, 1990; Riddell, 1990a).

**Table 1**  
**Value-Added in Manufacturing 1979-80 - 1985-86,**  
**at 1979-80 constant prices**  
(in Millions of Pula)

Production Group	1979-80	1981-82	1983-84	1985-86
Dairy and agro-based <sup>1</sup>	1.1	2.4	0.2	1.2
Beverages	3.2	9.6	7.7	7.2
Bakery products	0.3	0.4	0.4	0.7
Textiles	4.5	5.9	6.4	7.4
Tanning and leathers	0.7	-0.4	0.3	0.2
Chemical products	0.6	1.6	1.9	4.1
Wood and Wooden	0.5	0.4	0.3	1.3
Paper products	0.6	0.8	1.7	2.3
Metal products <sup>2</sup>	-0.3	1.4	5.3	6.2
Other manufacturing <sup>2</sup>	4.3	10.9	6.4	8.3
Village industries	4.7	5.2	5.6	6.0
<b>Total</b>	<b>20.2</b>	<b>38.2</b>	<b>36.2</b>	<b>45.4</b>

**Sources:** Harvey (1988); Lewis, Harvey, and Sharpley (1990).

**Note:** <sup>1</sup>Subsector's production was reduced by 1979-80 and 1982-88 droughts.

<sup>2</sup>Some output was reclassified from "other manufacturing" to metal products between 1981-82 and 1983-84.

In the latter half of the decade, manufacturing subsector growth was even faster than that for the whole period. Manufacturing value-added grew in real terms at an average rate of 6.8% at constant prices between 1984-85 and 1989-90. When the drought affected BMC is excluded the manufacturing subsector's performance becomes even more impressive, ranging in the area of 10% growth (Lewis, Harvey, and Sharpley, 1990; Republic of Botswana, 1991).

<sup>18</sup> For discussion on the effects of the six-year drought see Valentine (1993a) and Valentine (1993b).

Table 1 presents data on value-added in the manufacturing subsector, excluding meat and meat products, for the 1979-80 through 1985/86. Non-BMC manufacturing output at constant prices increased at a rate of slightly less than 15% per annum, albeit from a low base, from P20.2 million in 1979-80 to 45.4 million in 1985/86. The share of beverages, textiles and clothing had increased. Although the pace of diversification slowed during the early 1980s, as development was constrained by water shortages in the major industrial centers, another consequence of the drought, the share of those production groups was stable (Harvey and Lewis, 1990; Harvey, Lewis, and Sharpley, 1990).

Botswana's value-added data are published along with disaggregated national accounts statistics. The last statistics available at the time of the writing of this paper were for 1985/86. In order to make an educated guess at the direction of growth in the manufacturing subsector after that year, I rely on Location of Manufacturing licenses issued (and on manufacturing employment) to be discussed in section 4.3 below) as an indicator of the rate and direction of sectoral growth.

Table 2 presents data on the sectoral distribution of manufacturing licenses issued for the 1985-90 period. Over this period 475 new manufacturing licenses were issued, with the upper limits of the direct employment effect expected at nearly 27,000<sup>19</sup>. To put these 475 licenses issued in perspective, it should be recognized that the total amount of active manufacturing licenses in circulation at the beginning of 1988 was 823 -- 482 of which were for business whose only employees were the owner-operator and his/her family members (Smith et al., 1988; Kaplinsky, 1991).

These data illustrate that the tendency for production in Botswana was to concentrate on light industries -- beverages, food processing, and textiles and clothing -- reflecting the early stage of the economy's industrial development. These industries are less skill intensive than intermediate and capital goods industries. Yet, indicators are that there is a potential for diversification into simply chemical and rubber products, metal products and building materials. The expansion of these industries is most likely related to the rapid expansion of the educational system (and the construction of new schools building), the expansion of mineral production (with the mineral sector being the major "consumer" of chemicals and metal products), and the construction boom which occurred at the end of

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<sup>19</sup> Expected employment figures are derived from the forecasts given by applicants for manufacturing licenses. Employment actually generated almost certainly less than this (Republic of Botswana, 1991).



the drought and as the government embarked upon its accelerated serviced land program (Republic of Botswana, 1991).

**Table 2**  
**Manufacturing Licenses Issued 1985-1990,**  
**and Expected Employment by Sector**

<b>Production Group</b>	<b>1985</b>	<b>1986</b>	<b>1987</b>	<b>1988</b>	<b>1989</b>	<b>1990</b>	<b>Total</b>	<b>Expected Employment</b>
Meat & Meat Products	1	2	-	-	1	1	5	2150
Dairy & Agro Products	10	15	16	17	14	3	75	3000
Beverages	-	2	2	2	2	-	8	1000
Textiles	4	13	22	24	6	7	76	6400
Tanning & Leather Products	-	3	1	2	1	2	9	550
Chemical & Rubber Products	4	3	11	13	10	5	46	2200
Wood & Wooden Products	4	4	7	6	4	6	31	1500
Paper Products	3	6	1	5	3	3	21	1000
Metal Products	7	20	17	15	17	13	89	3650
Building Materials	4	10	7	14	12	11	58	2850
Plastic Products	4	6	5	6	4	6	32	1450
Electrical Products	2	5	4	4	3	4	22	800
Village Handicrafts	1	1	-	-	1	-	3	250
<b>Total</b>	<b>44</b>	<b>90</b>	<b>93</b>	<b>109</b>	<b>78</b>	<b>61</b>	<b>475</b>	<b>26800</b>

The manufacturing subsector grew rapidly, becoming more diversified and more dynamic. FAP has assisted the economic diversification of the manufacturing subsector; 16% of FAP medium and large-scale enterprises were in textiles and garments, 9% in metal working and 6% in cement and brick-making. Citizen participation in industrial activity in the form of direct ownership of productive enterprise and joint ventures increased significantly.

**Table 3**  
**FAP Financed Projects by Size**  
1985 - 1990

Location	Medium-Scale				Large-Scale		Total	
	CFA a		AFA b		No.	P'000	No.	P'000
	No.	P'000	No.	P'000				
Gaborone	72	25,962	42	61,329	7	15,002	121	102,293
Francistown	17	4,464	23	34,677	-	-	40	39,141
Lobatse	16	3,886	2	473	-	-	18	4,359
Selebi-Phikwe	13	5,741	16	32,165	1	3,203	30	41,109
Jwanen	2	293	3	829	-	0	5	1,122
Southern	17	3,249	1	700	1	1,580	19	5,529
South-East	16	3,719	13	12,756	1	1,907	30	18,382
Kgalaadi	-	-	-	-	-	-	0	0
Ghanzi	-	-	-	-	-	-	0	0
Ngamiland/Maun	4	530	1	95	-	-	5	625
Chobe	2	129	1	42	-	-	3	171
North-East	2	258	-	-	-	-	2	258
Central-Tutume	7	1,691	2	495	-	-	9	2,186
Serowe	6	1,446	1	148	-	-	7	1,594
Bobonon	1	41	-	-	-	-	1	41
Mahalape	5	1,613	-	-	1	1,751	6	3,364
Kgatleng	4	640	2	699	3	13,308	9	15,647
Kweneng	17	3,951	3	10,447	-	-	20	14,398
<b>Total</b>	<b>201</b>	<b>57,613</b>	<b>110</b>	<b>155,855</b>	<b>14</b>	<b>36,751</b>	<b>325</b>	<b>250,219</b>
<b>Percent of Total</b>	<b>61.8</b>	<b>23.0</b>	<b>33.8</b>	<b>62.3</b>	<b>4.3</b>	<b>14.7</b>	<b>100</b>	<b>100</b>

Sources: Republic of Botswana (1991:237).

Notes: All monetary terms are in current prices.

Table shows size of total investment, including FAP contribution and sums raised by investors themselves.

(a) CFA = Case by Case Financial Assistance.

(b) AFA =Automatic Financial Assistance.

Table 3 presents data on FAP financed projects by size for the years 1985 - 1990. Between 1985 and 1990, 325 MSE and LSE industrial projects were financed. The total project financing required amounted to P250 million, including the FAP contributions and those put up by the investors. Out of this amount over P50 million was in terms of direct FAP assistance, with a sizable proportion of the investors contribution being in the form of loans acquired from the National Development Bank. MSEs, located mainly in urban and peri-urban areas where the basic infrastructure was better developed, accounted for 85.3% of total investment. CFA recipients represented 61.8% of all MSE AND LSE projects and accounted for 23% of total investment. AFA recipients, which are primarily comprised of foreign-wned enterprises, represented 33.8% of a projects and accounted for 62.3% of total investment. LSEs represented 4.3% of projects assisted and but accounted for 14.7\$ of total investment (Republic of Botswana, 1991: 237).

## **4.2 Citizen Participation**

While the Botswana government maintained a liberal, market-oriented approach towards ownership and investment in the industrial sector, over time its policies shifted increasingly towards stronger support for citizen-owned and managed enterprises. Between 1979-80 and 1984-85 there was little change in the Botswana's enterprise ownership structure of licensed enterprises. UNIDO (1987: 27) reports that in fact, there had been "a slight decrease in the ratio of both locally owned and joint venture firms, and an increase in the share of wholly foreign owned firms." However, when FAP became operational, and was slightly modified after its first evaluation (Isaksen, Kaplinsky, and Odel, 1984), this changed significantly.

Table 4 presents data on CFA recipient enterprises by citizenship. Out of the total projects funded between 1985 and 1990, 64% were citizen-owned, 27% were foreign-owned and 6% were joint ventures. Citizen-owned enterprises were concentrated in the areas of meat & meat products, dairy & agro-based manufacturing, bakery products, textiles (clothes making/tailoring), metal products, building materials manufacturing, and furniture. This can not all directly attributable to FAP, however.

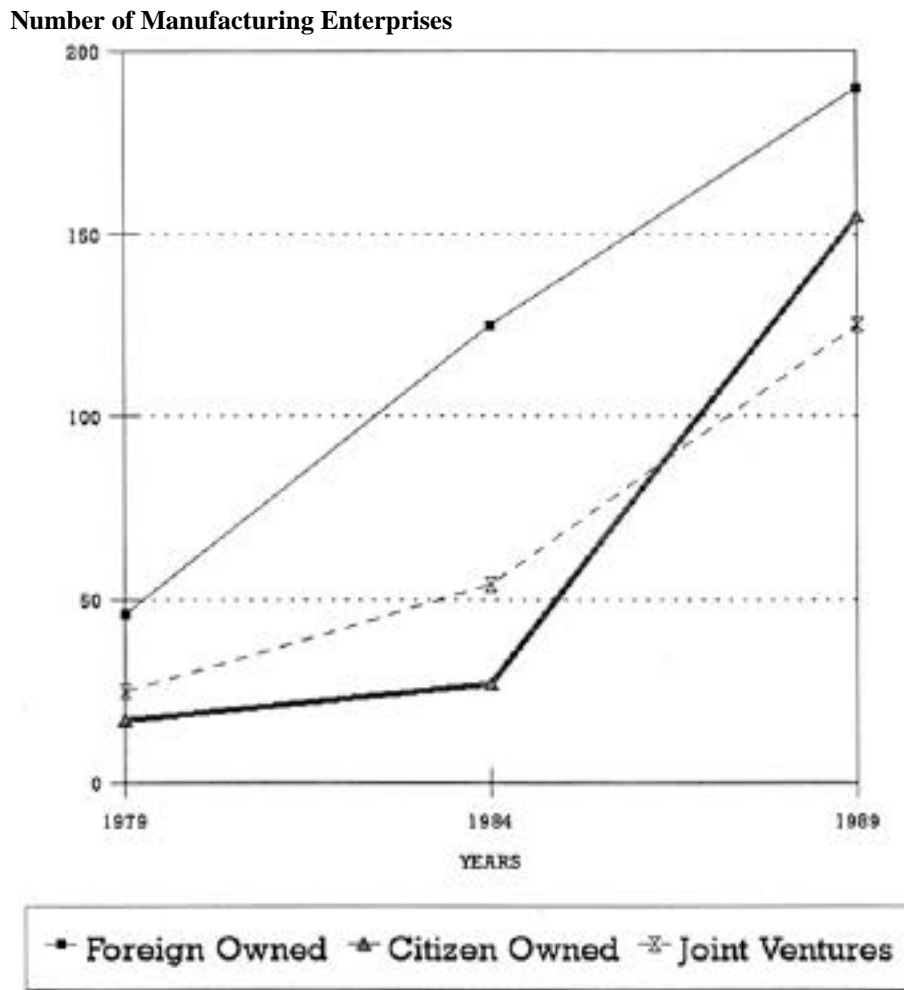
To promote active participation of citizens in industrial development, in 1984 under the new national industrial policy the government introduced an industrial reservation scheme. A number of industries which require relatively simple technological skills and low capital were reserved for citizens. Among the industries in this category were those manufacturing school uniforms and protective clothing (covered under textiles), school furniture, burglar bars and wire fence making, cement blocks and baked bricks, milling of sorghum and baking of bread. The rapid increase in the number of citizens operating in these enterprises reflected growth in local entrepreneurial talent (Republic of Botswana, 1991: 229).

**Table 4**  
**Case by case Financial Assistance: Citizenship by Sector 1985-1990**  
**(Main Production Groups of Manufacturing Subsector Only)**

Production Group	Citizens		Foreign		Joint Ventures		Organizations		Groups		Total
	No.	%	No.	%	No.	%	No.	%	No.	%	
Meat & Meat Products	19	90	2	10	0	0	0	0	0	0	21
Dairy Agro-based	24	86	1	4	2	7	1	4	0	0	28
Food Processing	8	47	7	41	0	0	1	6	1	6	17
Bakery Products	10	71	2	14	2	14	0	0	0	0	14
Textiles		55	11	33	2	6	0	0	2	6	33
Tanning & Leather	2	29	5	71	0	0	0	0	0	0	7
Chemical & Rubber	2	33	3	50	1	17	0	0	0	0	6
Wood & Wooden Products	3	30	4	40	3	30	0	0	0	0	10
Paper Products	5	38	6	46	1	8	1	8	1	8	13
Metal Products	11	52	9	43	1	5	0	0	0	0	21
Building Materials	15	88	1	6	1	6	0	0	0	0	17
Furniture	8	62	5	38	0	0	0	0	0	0	13
Other	6	26	13	57	1	4	3	13	0	0	23
<b>Total</b>	<b>181</b>	<b>64</b>	<b>75</b>	<b>27</b>	<b>18</b>	<b>6</b>	<b>4</b>	<b>1</b>	<b>3</b>	<b>1</b>	<b>281</b>

**Note:**Expected employment figures one derived front the forecasts given by applicants for manufacturing lime. Employment actually generated almost certainly less than this.

**Figure 1**  
**Ownership Trends in the Manufacturing Sector, 1979-1989**



Source: Republic of Botswana (1991).

Foreign-owned enterprises were concentrated in more complex manufacturing and large enterprises. The activities they engaged in included food processing, tanning and leather manufacturing, chemical and rubber manufacturing, hardwood furniture making, manufacturing wood and wooden products (primarily from hardwoods), and the manufacturing of metal products. About 87% of MSEs and LSEs assisted were citizen-owned, but about 65% of the total MSE and LSE grant amount went to non-citizens.

Figure 1 presents data on ownership trends in the manufacturing subsector. These data indicate that the number of foreignowned manufacturing enterprises increased at a more or less constant rate over the 1979-89 period, i.e., before and after the introduction

and subsequent revisions of FAP. However, the number of citizen-owned enterprises and joint ventures increased at much faster rates after 1984. The number of citizen-owned manufacturing firms increased almost five-fold between 1984 and 1989, while the number of joint ventures more than doubled over the same period. By 1987 for the first time in modern Botswana the number of citizen-owned enterprises in the manufacturing subsector surpassed joint ventures and was rapidly gaining on the number of foreign-owned enterprises.

Botswana was able to provide strong support for the promotion of indigenous entrepreneurs participation in the ownership of productive assets, both in the form of wholly citizen-owned and joint-owned enterprises, without outwardly slowing the rate of foreign-owned enterprise growth.

#### **4.3 Contribution to the Employment-Creation Objective**

A key indicator of general economic performance, as well as how the benefits of economic growth are distributed, is the rate at which FSE grows, and labor is transferred from less productive (and less remunerative) nonwage-based activities to FSE activities. FAP contributed significantly to the realization of government's employment-creation policy objective. FSE, led by employment in the manufacturing subsector, grew rapidly. Figure 2 presents indices of FSE trends for various sectors of the Botswana economy for the period 1980-1990.

The 1980s decade provides an interesting contrasts for analyzing FSE growth; it also provides insights as to the rate of acceleration in Botswana's economic growth. Two distinct periods become evident 1980-85 and 1985-1990. The strong economic growth that Botswana experience during 1980-85 is clearly illustrated. FSE rose at an impressive rate of roughly 7.0% per annum in 1980-85, increasing from 83,400 in 1980 to 116,800 in 1985. Then in 1985, owing in part to a change in government industrial policy, and the introduction and subsequent revisions in FAP, employment began to grow rapidly. In 1985-90 FSE growth accelerated. By 1990 -employment had reached 213,400, to an exceptional rate of 12.5% per annum.

Over 1980-90 FSE increased at an average annual rate of roughly 9.6%. In 1985-90 the private and parastatal employment growth rate far outpaced that for total government, at 15.4% as compared to 8.3%<sup>20</sup>. This was a result of the growth in non-mining activities

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<sup>20</sup> Private and parastatal employment are presented together here, as before 1985 separate employment statistics were not reported for the private and parastatal sectors.

in the secondary sector (manufacturing and construction) and non-government tertiary sector (particularly, trade and commerce, business services and financial services).

Manufacturing employment growth provided the lead. After 1985 the manufacturing employment growth rate far outpaced that for other subsectors of the economy. Employment in manufacturing grew at 12.1% and 20.9% in 1980-85 and 1985-90 respectively<sup>21</sup>. Manufacturing employment increased from 5,600 in 1980, to 9,900 in 1985, to (an estimated) 26,600 in 1990. Manufacturing employment increased rapidly in absolute terms, by nearly five-fold over the total period, and in relative terms -- from 6.7% of FSE in 1980, to 8.5% in 1985, to 12.5% in 1990.

Private sector and parastatal enterprises appear to have reached a level of growth and mature, having been embryonic when the period of rapid growth began in 1972 and continued to be so into the early 1980s. Between 1985 and 1990 private sector employment nearly doubled, growing from 63,600 to 124,300 jobs. FAP played a major contributory role here. In 1990 the sector composition of employment shows that the private sector accounted for 64% of the 213,400 total employees. The sector composition total government (central and local government) followed at 31% and parastatal enterprises at 5%.

As employment growth far outpaced the growth of the economically active population, a greater and greater the proportion of the economically active population has been absorbed into the formal sector, although unemployment and underemployment still remains a problem for unskilled/low-skilled citizen labor<sup>22</sup>. In 1972 slightly over 12% in wage employment. momentum gained in employment grew of the economically active population was engaged By 1981 this had increased to 18.5%. With the employment growth, in the mid 1980s wage much more rapidly than the economically active population. This point is illustrated by the percentage of the economically active

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<sup>21</sup> The growth of the manufacturing subsector and manufacturing employment is, of course, not simply a result of FAP in Botswana, but of the overall macroeconomic policy-mix. For a more detailed discussion of the policy-mix, see Harvey and Lewis (1990); Lewis, Harvey and Sharpley (1990); and Valentine (1993b).

<sup>22</sup> The concept of "economically active population" is used here instead of "labor force". The difference between the two concepts is as follows. The former concept comprises the total proportion of the population between the ages of 15 and 64, regardless of their status in the labor force. The latter concept comprises only those who actually work for others or for themselves, as well as those who are actively seeking work. For various reasons, generally related to age and/or gender, not everyone in the economy between the ages of 15 and 64 participates in the labor force. There are students, the disabled, the discouraged work seekers, etc. who are not presently participating in the labor force. In general, in developing countries, less than 55 percent of the economically active population are participants in the labor force.

population engaged in FSE growing from about 19% in 1985 to nearly 28% in 1990 (Valentine, 1993b).

## **5. FAP Limitations**

Data on grant commitment per job created show that, while there is much room for improvement, FAP represents a good investment of public funds for sustained development<sup>23</sup>. Even making the very conservative assumption that the only economic or social benefits of the jobs created are the wage payments at the minimum industrial wage, SSE grants pay back in 1.3 years and CFA ones in 8.3 years, or 3.3 years after the grant period ends (Smith et al., 1988; Kaplinsky, 1991). Naturally, such payback will occur only if the FAP created employment does not evaporate during the payback period, which implies that application appraisal should rigorously exclude cases in which the grant is likely to yield only short-term employment.

Still, the experience of FAP suggest that, while the program did address significant problems of enterprises and did help to generate employment at an acceptable investment per job (Smith et al., 1988), it failed to support firms in a number of key areas.

The limitations of FAP as a productive enterprise development and diversification scheme are now considered. These limitations are in the areas of: geographical diversification; scale of operations and linkages; skill labor constraint; export promotion effects; and need for nonfinancial assistance.

### **5.1 Geographical Diversification**

FAP has not assisted in the promotion of geographical diversification of Botswana by spreading industrialization more evenly throughout the country. MSE and LSE FAP recipients were very much concentrated in the four major urban/ peri-urban locations. This is clearly illustrated in Table 3 which presents FAP data by category and geographical location. These four locational zones (Gaborone, Francistown, Selebi-Phikwe, and South East) comprise about 20.8% of Botswana's total population. Yet, 68% of the MSEs and LSEs projects are located in these zones and more importantly 80.3 percent of all FAP assistance for MSEs and LSEs is concentrated in these zones.

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<sup>23</sup> Kaplinsky (1991) presents a major criticism of FAP from the standpoint that there has been too much reliance on financial assistance to solve non-financial market failure problems. He argues that there are a lot of free-riders, particularly among noncitizen investors. Kaplinsky's argument is that non-citizens (and many citizens as well) are not confronted by a financial constraint in their decision to invest in Botswana. Provision of finances in circumstances such as these may simply act as a capital subsidy to these investors.



Comprising about 10% of the total population, Gaborone (the capital) was the location of 37% of the recipient enterprises and accounted for 41% of funding for MSE and LSE projects. This points to a major problem, and a woefully inadequacy, locational factor in the calculation of FAP assistance. Of course, a locational factor alone is not likely to correct the transaction-cost differentials of conducting business in areas where physical and social infrastructure is lacking and transport and communication networks are extreme poor.

However, Selebi-Phikwe, a copper-nickel mining town where about 4% of the population resides and whose ore reserves are being exhausted, is a clear example of how industrialization can be promoted in areas in which the government make it a priority. The government's concern is to promote productive economic activity to replace to reliance on the declining copper-nickel industry, an industry that has experienced the vagaries of international market price fluctuations. While being an urban area, and having a good transportation network, though a bit out of the way, Selebi-Phikwe FAP projects are accorded the same locational factor as projects in the rural area east zone. (In addition, there are other nonfinancial benefits of locating in this town. For example, a special unit has been set-up to encourage enterprises to locate in Selebi-Phikwe and offers nonfinancial assistance to prospective investors, particularly foreign investors.)

## **5.2 Scale of Operations and Linkages**

A fundamental limitation of reliance on a FAP-approach is that a finance-intensive strategy does little to facilitate the industrial sectors move beyond the easy phase of import-substitution; many of Botswana's industrial park inhabitation can be accurately described as chimney-less factories, simply assembling or otherwise adding very little value to product. There is little evidence of increased economies of scale or productive efficiency among domestic producers, especially. citizen-owned enterprises.

Through FAP, the Botswana government has shown strong commitment to using a finance-intensive strategy to addressing the industrial development problem. In an attempt to relax the equity finance constraint of the development of citizen-owned enterprises and to raise the scale of operation of these enterprises, following a recommendation of the 1988 FAP evaluation (Smith et al., 1988) the government increased the amount of the (pre-production) capital grant of 100% citizen-owned projects by 50%, from P1,000 to P1,500 per production job expected to be created.

There is no evidence that the increased financial assistance has had the desired effect, as the scale economies and productive efficiency problem is not merely financial in nature. Addressing this problem requires an overall commitment by management, and public policy and financial institutions support. It requires more appropriate machinery and technologies, improved management techniques, expanded research and technological capabilities, innovative ways of raising labor productivity, improved product design and quality control, and attempts to reduce comparative transport disadvantages (Kaplinsky, 1991; Riddell, 1990a; Riddell, 1990b).

The financial and skill requirements necessary to address this problem go beyond what the typical MSE and LSE in Botswana, or most developing countries for that matter, would be able to bear. Public financial support may be of significant in getting the required institutions and cooperative relationships in place which will assist in addressing this problem<sup>24</sup>.

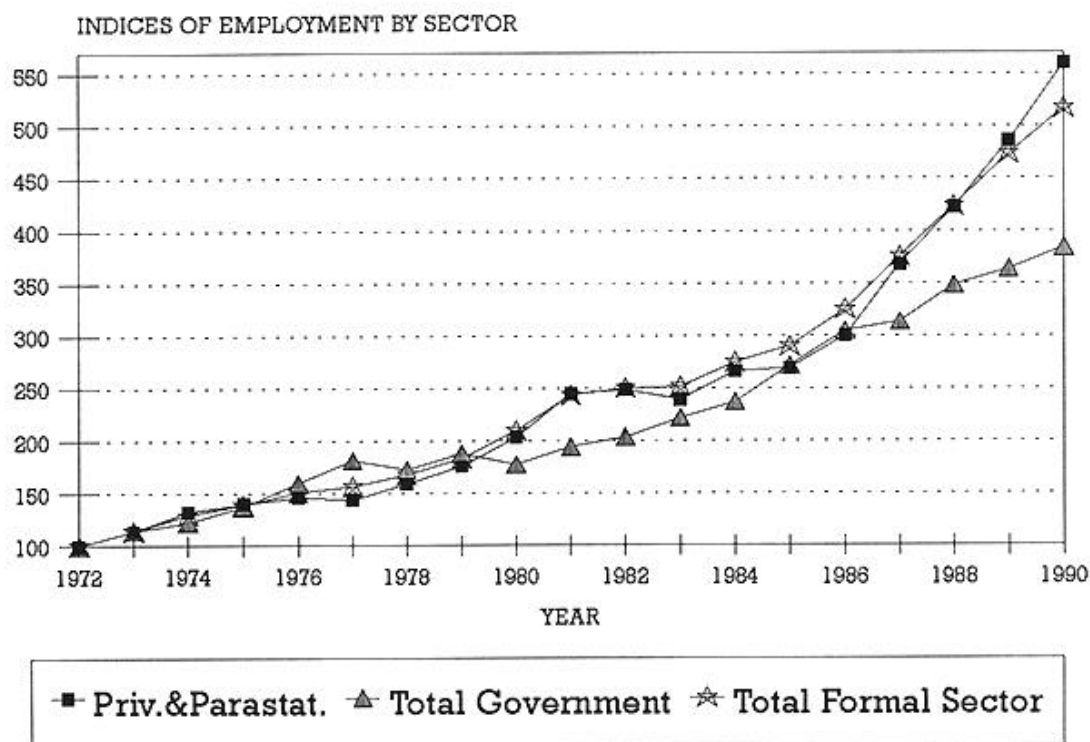
### **5.3 Skilled Labor Constraints**

The 1988 FAP evaluation report (Smith et al., 1988) found that FAP made little or no contribution to skill acquisition for the following reasons. First, there are few if any agencies or external institutes where unskilled workers can be trained in a short enough time or at hours practical for employers. Second, FAP excludes support of on-the-job training, which enterprises consider to be the most helpful skill development method. And third, if workers are trained and subsequently upgraded and is paid a higher wage.. Selebi-Phikwe and offers nonfinancial assistance to prospective investors, particularly foreign investors.)

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<sup>24</sup> See Kaplinsky (1991) for further discussion.

**Figure 2**  
**Indices of Formal Sector Employment by Broad Sector, 1972-1990**  
**(1972=100)**



Sources: Republic of Botswana, Central Statistics Office (various issues) and (various years)

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To date, little use has been made of the training grant unskilled labor. However, according to the 1988 FAP evaluation report, there exist the very real possibility of on-site training sessions for unskilled workers carried out by company training officers and outside firms that provide such services. To address the perceived underutilization of the evaluation report recommends the following. First, there is a case for on-site unskilled labor training grants, provided adequate documentation of those costs directly incurred for such training are presented. These can be in the form of preliminary estimates and adjusted accordingly against the next year's labor grant.

Second, enterprises should be allowed in their labor grants calculations to retain the unskilled-wage portion of employees who have been successfully trained and promoted. The situation was that as workers completed their training and were promoted up the job

ladder, their wages rose above the maximum allowable wage for unskilled labor as defined by FAP guidelines. Employers would cease to be reimbursed for such workers under the labor grant. This posed a dilemma to employers who wished to benefit from the training grant. Some enterprises that wished to train were pursued to abuse the labor grant component by understating reported wages of trained employees. Other enterprises refuse to give raises to trained employees, thus reducing their motivation to seek training, and increasing the source of industrial conflict and disharmony<sup>25</sup>.

In principle, these recommendations have merit. In practice under-training in Botswana is not simply a FAP problem, but an economy-wide, market failure problem. This is a market failure that financial assistance alone can not successfully address.

With the low level of education, the low levels of exposure to technical equipment, and the lack of industrial experience, as was stated above most workers are first or second generation wage employees, much of the education and training that the workforce required was general in nature, at least initially. Even with FAP support, most employers are unwilling to incur the cost of this general training. In order to reap the returns from their investment, employers would have to hold the worker's pay significantly below what the labor market is willing to pay for such skills given the present acute shortage of manpower. Workers are likely to become dissatisfied, reducing their work-effort, or simply seek employment elsewhere.

Most manufacturing industries in Botswana are quite small and use fairly low levels of technology by international standards. Enterprises are generally characterized by low levels of skill specificity and short job ladders, leading to a weakening of the tendency for internal labor markets to develop. Facilities to undertake in-house training are likely to be uneconomical.

In the firms that are large enough to potentially benefit from formal training, whether in-house or off-the-job (in a recognized training institution), are operated by expatriates and/or have expatriate managers. Foreign owners and managers have little understanding of or appreciation for Botswana's culture, lack sensitivity of local conditions and customs, and lack understanding of and appreciation for the variables that motivated citizen manpower. They question workers' loyalty and find that workers do not take a long-term view of career opportunities and training prospects.

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<sup>25</sup> The 1988 FAP evaluation report states that some interviewed enterprises admitted to understating reported wages of such employees. Other enterprises refuse to give raises to trained employees, thus reducing their motivation to seek training. See Smith et al., 1988.

In many cases they have a difficult time gauging which workers, or potential employees, are likely to successfully undergo training and to estimate the increased production from such training. This uncertainty leads to increased expected costs of training and reduced benefits. The result is a low willingness to train citizen workers, and a strong preference for recruiting and retaining expatriates where the law permits. Given the labor market situation of rapidly increasing demand for skilled labor and the potential loss of such labor to other employers, there is little incentive to train. The ability to successfully complete a formal training program is a strong labor-market signal that other employers are not likely to ignore (Valentine, 1993c). The result is a labor-market situation that under values on-the-job training and over-emphasizes formal education and training and credentialism.

#### **5.4 Export Promotion Effects**

FAP has had negligible impact on export promotion (Kaplinsky, 1991; Smith et al., 1988). As is indicated by Lewis, Harvey, and Sharpley (1990) only about 7.9% of non-BMC manufacturing growth can be traced to exports. And even here the growth of exports is primarily a result of Zimbabwe (and/or ex-Zimbabwe) nationals moving their enterprises across the border into Botswana<sup>26</sup>. They were pushed by Zimbabwe's foreign exchange shortages and controls, input shortages, and controls profit repatriation; pulled by Botswana's favorable financial and regulatory environment, as well as the availability of FAP funding. These enterprises (mainly textile manufacturers and food-processors) targeted the Zimbabwe market. These enterprises along with a few firms that exported labor-intensive products to the RSA, made up the bulk of non-BMC manufacturing exports.

There has been some success in the establishment of enterprises with markets outside the southern African region, but this has been fairly limited. For the most part, exports have done little to assist domestic producers to expand their economies of scale to lower domestic cost of production or to make domestic producers more competitive.

The FAP is unlikely to successfully assist in the promote of exports. The sales augmentation grant is woefully inadequate for this purpose. Perhaps, the government needs to development a different program to promote exports, with a assistance-package

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<sup>26</sup> Kaplinsky (1991) refers to this as the "Francistown factor", as most of the ex-Zimbabwean (or ex-Rhodesian) enterprises are located in Francistown, a *town* located *in* northeastern Botswana close to Zimbabwe border.

financial and non-financial incentives/ support, and to entice foreign investors who are export-oriented.

### **5.5 Need for Nonfinancial Assistance**

Many MSEs and LSEs also have marketing problems and some lack skilled labor. Although lack of finance is more likely to affect citizen-owned enterprises and has been identified by citizens as the major constraint on enterprise development and expansion than foreign enterprises, it is usually not their major problem. Data from MSEs and LSEs suggest that an industrial policy such as FAP, which focuses merely on finance, is unlikely to meet the full range of enterprise-development problems (Kaplinsky, 1991; Smith, et al., 1988). Non-financial assistance in the form of managerial and technological assistance may be of great importance in raising the likelihood of success of citizen-owned enterprises, and assisting in raising enterprises out of their infancy.

In many cases of enterprise development, the provision of finance may be addressing the wrong sort of market failures. The need for additional finances may "signal", be a symptom, that there is a problem instead of being the manifestation of the problem. There is a need for assistance in terms of management development and training, technological development and choice, and productive services.

## **6. Conclusions**

Much today is written about the role of government in the industrialization process being limited to the creation of an enabling environment and getting the prices right<sup>27</sup>. However, there is a growing body of evidence that a strong commitment to industrialization by late industrializers in general and small LDCs in particular requires, *inter alia*, the institutionalization of financial innovations that reduce the financial impediments and other forms of government assistance<sup>28</sup>.

If Botswana is to continue to record an acceptable rate of real economic growth and employment growth, let alone match its past economic performance in the absence of new mineral projects or increase in mineral revenues (due to increased sales of product or

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<sup>27</sup> See Colclough (1991) for a general discussion on this view in development economics; see Shapiro and Taylor (1990) for discussions in the area of LDCs industrialization policy; and see Behrman (1986) for a critique of FAP within the context of the getting the prices right argument.

<sup>28</sup> See Westphal (1990) and Rock (1992) for discussions on the role played by the South Korean government in addressing issues of the country's scale economies, productive efficiency, and export-constraint problems. See Schimtz and Hewitt (1991) on government assistance in moving industry beyond the infant-industry stage in Latin America.

increased prices), it must achieve further manufacturing growth and deepening of manufacturing.

Owing to financial reserves acquired from the mineral sector, the government was able to pursue a (fairly successful) financeintensive approach to relaxing constraints on private enterprise development. According to various studies (for example Kaplinsky,1991; Smith et al., 1988; UNIDO, 1987), financial assistance was rendered in a cost-effective manner, though in some cases assistance was given for programs what would have been successfully undertaken in the absence of such assistance. However, for the most part the provision of equity finance, and labor subsidies helped to improve the profit-risk tradeoffs facilitating the development and expansion of the industrial sector and assisting in promoting citizen participation in this subsector, through both rapid employment growth and the promotion of indigenous entrepreneurship.

The resulting successful industrialization growth, with increased citizen participation, helped the government to resist a more protectionist development approach. However, it should be noted here that Kaplinsky (1991) warns that, with MSE and LSE FAP assistance being open to all-comers, in the future there is an increasing likelihood that potential productive opportunities to be blocked for emergent indigenous entrepreneurs, potentially blocking the accretion of indigenous technological capability, leading to political pressures on the government to intervene against foreign ownership. Such political tensions could be gradually building ready to erupt as economic growth slows and economic opportunities become more limited.

FAP and financial assistance in general is not a panacea for relaxing all constraints on industrial development. While significant potential remains for productive enterprise development and expansion, the major problems remain in the areas of consolidating industrial development, increasing scale economies, and raising productive efficiency.

The wide variety of grant components do not appear to have much effect on influencing components of business behavior. For example in the case of foreign-owned enterprises high labor costs are not seen as a major problem, so the labor subsidy is more likely to be used for fixed-asset or materials purchases than it is for hiring more labor. However, the grant as a whole stimulated employment because it facilitates investments which allowed enterprises to grow enough to need more employees (Smith et al., 1988) .

It is likely that the manufacturing subsector has few more years in which it can expect to derive most of its growth from domestic demand as in the past. In the medium term,



though, manufacturing will have to rely more on import substitution and, even more so, on improvements in scale economies and increased productive efficiency. Given the small size of the Botswana domestic market, in the long term the market-size constraint may serve to limit scale economies requiring significantly increased exports if the economy is to grow rapidly (Harvey and Lewis, 1990: 37) .

The easy phase of import substitution may be drawing towards an end. Further effort will be required to consolidate industrial development, increase scale economies, and to improve productive efficiency -- leading to the deepening of manufacturing.

The expansion and deepening of manufacturing may require the continuing of public sector financial assistance. However, the future will require a different type of assistance, less finance intensive in nature. The success of the Botswana economy in meeting the challenges ahead may depend on how successful public sector intervention is at facilitating cost-sharing and riskspreading for private sector development, improving the profit-risk tradeoffs in a sustainable way.

Further public sector intervention, benign intervention, may be required to extend cost-sharing and risk-sharing into nonfinancial areas, creating the potential for further improvement in the profit-risk tradeoff and leading to the deepening of manufacturing in Botswana.

As pointed out by Schmitz and Hewitt (1991: 174): "Of course, skepticism about the difficulties of successful state intervention is justifiable, given that many industrial failures have been policy-induced... (N)eoliberals have contributed a great deal to the critical analysis of state intervention, particularly with their work on policies of protection. However, sight is often lost of the fact that governments need to learn how to promote industrial development. Moreover, aphorisms such as 'imperfect markets are better than imperfect states' seem to introduce an unwarranted passivism -- if not defeatism -- in to the debate on industrial policy." [Emphasis added] Botswana appears to be one African country where the government is learning how to promote industrial development. Now it needs to learn how to raise industrial infants.

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