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INVESTMENT POLICY REVIEW

RWANDA



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Investment Policy Review
Rwanda



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A blank in a table indicates that the item is not applicable.

A slash (/) between dates representing years – for example, 2004/05, indicates a financial year.

Use of a dash (–) between dates representing years – for example 2004–2005 signifies the full period involved, including the beginning and end years.

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PREFACE

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

The Investment Policy Review of Rwanda, initiated at the request of the Government, was carried out through a fact-finding mission in June-July 2005 and is based on information current at that date. The mission received the full cooperation of the relevant ministries and agencies, in particular the Ministry of Commerce, Industry, Investment Promotion, Tourism and Cooperatives and the Rwanda Investment and Export Promotion Agency (RIEPA). The mission also had the benefit of the views of the private sector, foreign and domestic, civil society and the resident international community, particularly bilateral donors and development agencies. A preliminary version of this report was discussed with stakeholders at a national workshop in Kigali on 20 June 2006. The report was also presented to members of the Economic and Trade Committee of the Chamber of Deputies and of the Committee on Economy and Finance of the Senate.

This report was prepared by Rory Allan and Quentin Dupriez with guidance from Fiorina Mugione and under the overall supervision of Khalil Hamdani. It was funded by the Government of Germany (BMZ), which also provided financing for follow-up activities currently underway.

It is hoped that the analysis and recommendations of this Review will help Rwanda achieve its development goals, contribute to improved policies, promote dialogue among stakeholders and catalyse investment.

Geneva, July 2006

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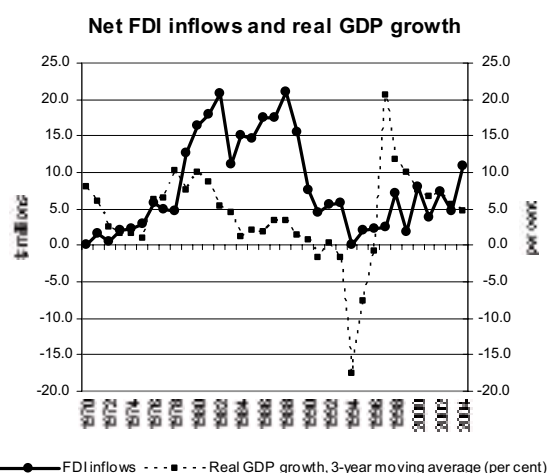
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ABBREVIATIONS

AGOA	African Growth and Opportunity Act
ASEAN	Association of South East Asian Nations
BIT	bilateral investment treaty
BNR	Banque Nationale du Rwanda
BPO	business process outsourcing
CEPGL	Communauté Economique des Pays des Grands Lacs
CIF	cost insurance and freight
COMESA	Common Market for Eastern and Southern Africa
DFID	Department for International Development
DTT	double taxation treaty
EAC	East African Community
EIA	environmental impact assessment
EBA	Everything But Arms
EPZ	export processing zone
EU	European Union
FAO	Food and Agriculture Organization
FDI	foreign direct investment
FOB	free on board
FPR	Front Patriotique Rwandais
GATT	General Agreement on Tariffs and Trade
GDP	gross domestic product
GSP	Generalized System of Preferences
HIPC	heavily indebted poor countries
ICSID	International Centre for Settlement of Investment Disputes
IPP	independent power producer
ISP	internet service provider
IT	information technologies
ITES	internet-enabled services
LDC	Least Developed Country
M&A	mergers and acquisitions
MaGeRwa	Magasins Généraux du Rwanda
MDGs	Millennium Development Goals
MFN	most favoured nation
NGO	non-governmental organization
NIS	national investment strategy
NPLs	non-performing loans
OBU	offshore banking unit
OFSC	offshore financial services centre
PPA	power purchase agreement
PPP	purchasing power parity
PRGF	poverty reduction and growth facility
PRSP	poverty reduction strategy paper
Redemi	Régie d'Exploitation et de Développement des Mines
REMA	Rwanda Environmental Management Authority
RIPA	Rwanda Investment Promotion Agency
RIEPA	Rwanda Investment and Export Promotion Agency
RRA	Rwanda Revenue Authority
RURA	Rwanda Utilities Regulatory Agency
SADC	Southern African Development Community
SMEs	small- and medium-sized enterprises
SMIG	salaire minimum interprofessionnel garanti
SPS	sanitary and phytosanitary standards
TNCs	transnational corporations
UNCTAD	United Nations Conference on Trade and Development
VAT	value added tax
WIPO	World Intellectual Property Organization
WTO	World Trade Organization

RWANDA - STATISTICAL OVERVIEW



MAIN ECONOMIC AND SOCIAL INDICATORS

Indicator	1980-85 average	1985-90 average	1990-95 average	1995-2000 average	2001	2002	2003	2004
Population (million)	5.6	6.5	6.7	6.8	7.9	8.2	8.4	8.4
GDP at market prices (\$ billions)	1.5	2.2	1.8	1.7	1.7	1.7	1.7	1.8
GDP per capita (dollars)	259.4	337.5	263.4	250.4	214.6	212.2	200.6	219.3
Real GDP growth (per cent)	3.7	2.0	-3.7	14.0	6.7	9.4	1.0	3.7
Poverty rate (percentage living with under \$1/day)	35.7	..	..	51.7	..	..	..	..
GDP by sector (per cent):								
Agriculture	41.2	38.2	37.6	44.3	40.5	41.9	41.6	..
Industry	22.3	20.5	20.0	18.5	21.6	21.6	21.9	..
Services	36.4	41.3	42.5	37.1	37.9	36.6	36.5	..
Trade (\$ millions):								
Merchandise exports	107.0	123.3	71.7	62.3	85.0	56.0	58.0	80.0
Services exports	33.6	42.9	28.0	41.5	65.9	65.2	..	..
Merchandise imports	277.8	331.7	281.0	256.7	250.0	248.0	245.0	250.0
Services imports	120.3	132.0	136.3	181.0	189.2	201.5	..	..
Capital flows (\$ millions):								
Net FDI flows	16.0	15.7	4.3	3.9	3.8	7.4	4.7	10.9
Net flows from private creditors	0.5	-2.4	-0.6	0.0	0.0	0.0	0.0	0.0
Net flows from official creditors	36.9	70.2	53.0	55.6	54.2	76.6	19.7	82.6
Grants	69.6	93.7	313.5	276.8	154.0	185.0	201.0	..
Life expectancy at birth (years)	46.3	44.2	37.5	40.2	..	39.8	39.8	..
Infant mortality rate (per thousand)	130.0	103.0	113.5	121.0	..	..	118.0	..
Literacy rate, adult (per cent)	..	..	..	64.0	..	..	..	..
Literacy rate, youth (per cent)	..	..	..	76.5	..	..	..	..

Sources: UNCTAD, FDI/TNC Database; World Bank; World Development Indicators; UNDP, Human Development Report 2002, 2003 and 2004.

INTRODUCTION

Rwanda is among the world's poorest nations and it faces particular challenges in leveraging FDI for development as a result of its economic structure, the low level of development of human capital, its landlocked position and its small size. It suffered tremendous hardship as a consequence of the genocide in 1994 which, in addition to the human horror, led to the collapse of the economy and left much of the infrastructure dilapidated or destroyed.

Despite the instability in the Great Lakes region, political stability and personal safety have been restored in Rwanda for a number of years. The Government has proved its resolute commitment to further entrenching peace and stability and fostering a private sector-led process of socio-economic development and transformation. The challenge is to sustain the recovery of the past few years, accelerate the process of economic transformation and correct the image of the country in the world. While it wants FDI to play a significant role in achieving national development goals, the Government has so far not developed a comprehensive FDI strategy. This Review seeks to fill this gap.

Chapter I provides an overview of the economic structure and the impact of FDI. Rwanda's economy is small and dominated by agriculture, with around 90 per cent of the population living in rural areas. The secondary and tertiary sectors are under-developed and provide little formal employment. The level of formal skills and human capital is low in spite of recent successes in boosting primary education, the quality of infrastructure is generally poor, and the country does not have significant natural resources. This means that Rwanda lacks the main drivers of foreign investment by large transnational corporations in search of resources, markets or competitive centres of production. As a result, it has to date attracted little FDI and the impact on the economy has been limited. High operating costs, the small size of the domestic market and the lack of development of the industrial and services sectors imply that it is illusory to attract FDI from the major TNCs at the moment. Instead, Rwanda is much more likely to attract interest from small- and medium-scale enterprises (SMEs) and from individual investors, particularly from within the region.

Chapter II examines the investment framework. Rwanda has an open regime to FDI, and the Government has embarked upon an ambitious programme to modernize the investment framework. The aim is to provide a framework that both promotes investment and protects the national interest. Although the progress realized so far is impressive given the situation inherited in 1994, much remains to be done to upgrade the entire framework. A number of recommendations are offered to transform Rwanda into a centre of excellence in soft infrastructure and governance and to set up a skills attraction and dissemination programme. These two elements would be central to the strategy of turning Rwanda into an attractive business location and for correcting the image of the country abroad.

Chapter III proposes a strategy to enhance the role of FDI in achieving national development goals. Medium- and long-term constraints to FDI attraction are highlighted and likely foreign investors are identified, together with their probable market focus. The strategy proposes to mitigate the impact of hard infrastructure constraints by turning the country into a centre of excellence in soft infrastructure and governance in Africa by 2010. It also highlights that Rwanda is likely to benefit most from attracting skilled individual foreign investors to bridge the skills gap and ensure a transfer a competence, and proposes to establish a business talent scheme. In addition to "horizontal" measures to promote business development, the strategy suggests a number of policy packages to improve investment conditions and advance the process of economic transformation and wealth creation.

Chapter IV highlights the main findings and recommendations of the Review.

I. ECONOMIC STRUCTURE AND FDI IMPACT

Rwanda is one of the poorest countries in the world¹ and much of its population lives on subsistence agriculture. The formal industrial and services sectors are little developed and almost non-existent outside the few larger urban areas (essentially Kigali, followed by smaller urban centres such as Butare, Cyangugu, Gisenyi, Gitarama or Kibuye). The very high population density, pressure on limited and fragile arable land, and the reliance of a large share of the population on subsistence agriculture mean that the transformation of the economy will be essential to improve living conditions for the majority of the country's inhabitants. Although the structure of the economy and past policies have been such that little foreign direct investment (FDI) has been attracted, the Government is now keen for foreign investors to contribute to business development, hence participating to a private sector-led process of economic transformation, development and wealth creation.

A. Economic structure and the role of FDI

Rwanda faces particular challenges in leveraging FDI for development as a result of its economic structure, the low level of development of its human resources, its landlocked position and small size. These factors influence not only the level and type of FDI that the country is likely to attract, but also the kind of FDI that is likely to make the largest contribution to national development goals and poverty reduction. A clear understanding of Rwanda's economic structure and its evolution over the recent past is thus essential to assess the role FDI could play in the development of the economy and to formulate a strategy to attract and benefit from foreign investment. This section provides a broad overview of the structure of Rwanda's economy and the role of FDI.

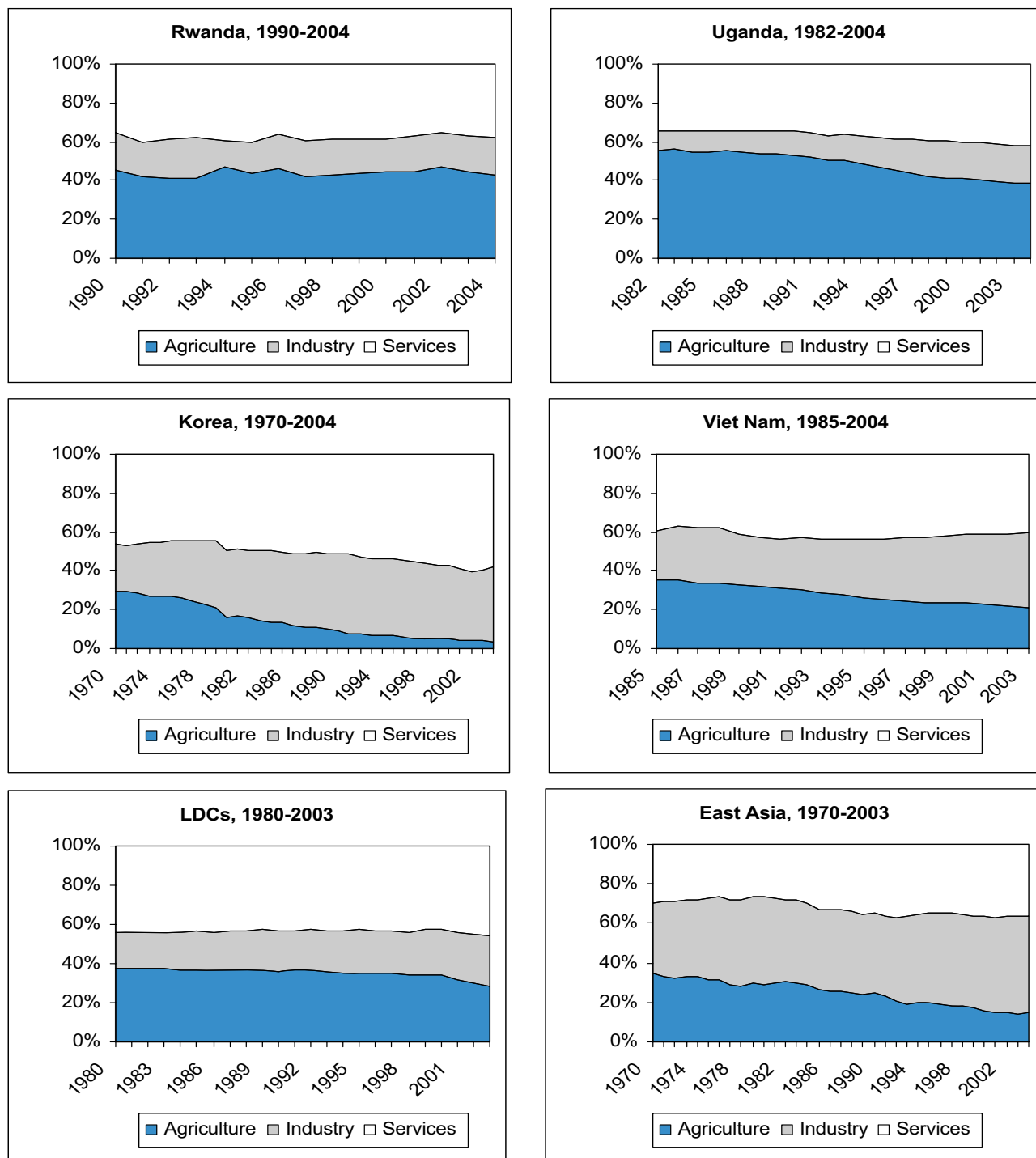
I. Output structure and FDI

The Rwandan economy has undergone little transformation over the past four decades. The share of agriculture in GDP has hovered around 44 per cent since the 1990s, similar to what it was in the early post-independence years (figure I.1). Similarly, the shares of industry and the services sector have stagnated at around 18 and 38 per cent, respectively. This lack of transformation is singular among world economies, including in sub-Saharan Africa and the least developed countries (LDCs), most of which exhibited a more marked evolution away from a rural economy. While agriculture represented close to 40 per cent of GDP on average in LDCs in 1980, the share fell to 28 per cent by 2003, while the share of industry and services rose to 26 and 46 per cent, respectively. In further contrast, agriculture still represented close to 40 per cent of output in East Asia in the late 1960s. Rapid industrialization then pushed the share of industry to about 50 per cent by 2004 and sharply reduced the prevalence of absolute poverty and increased the standards of living of the majority.² This degree and pace of transformation is what Rwanda will require if it is to succeed in eradicating absolute poverty and providing a sustainable livelihood to its rising population. FDI could play a significant role in that process of change.

¹ It was the 24th poorest country out of 180 in 2003, based on PPP real GDP per capita.

² The share of the population living with less than \$1 a day (PPP basis) in East Asia fell from 58 per cent in 1980 to 15 per cent in 2001. Source: World Bank, World Development Indicators.

Figure I.1. Sectoral composition of GDP
(Percentage of total)



Sources: World Bank, World Development Indicators and national sources.

In addition to remaining essentially a rural economy, over 80 per cent of agricultural output in Rwanda consists of food production for subsistence or domestic consumption. Export crops represent less than 2 per cent of agricultural output, with the residual accounted for by livestock, fisheries and forestry. Additionally, cash crops are almost fully accounted for by coffee and tea, and there has been almost no diversification so far, with a few notable exceptions (box I.1). Coffee production was severely

and lastingly disrupted by the genocide in 1994, as average output in 1995-2005 has stagnated at a level only half that of the period 1983-1993 (figure I.2). In contrast, tea production recovered much faster after 1994, even though total output in recent years has only been moderately higher than in the late 1980s. In both of these commodities, Rwanda represents only about 0.4 per cent of world output.

Box I.1. Rwanda Flora

Rwanda Flora, based in the Kigali area, is the largest of a handful of flower producers in Rwanda. The investor, a former Rwandan employee of the United Nations, took over and restructured an existing flower farm, bringing management skills and knowledge of the European market and sanitary and phytosanitary standards. Rwanda Flora employs about 200 people and currently only produces roses, but has plans to expand into tropical flowers.

Although there is no cargo space available direct to Europe, Rwanda Flora is able to export to the Netherlands through Nairobi, with which Rwanda has two daily flights. The absence of appropriate cold storage facility is remedied through an in-house cold storage room and last minute transfer from the farm to the airport. This is facilitated by the airport's proximity, and shipment inspections by the tax and Customs authorities are carried out on the farm.

Source: investor interview.

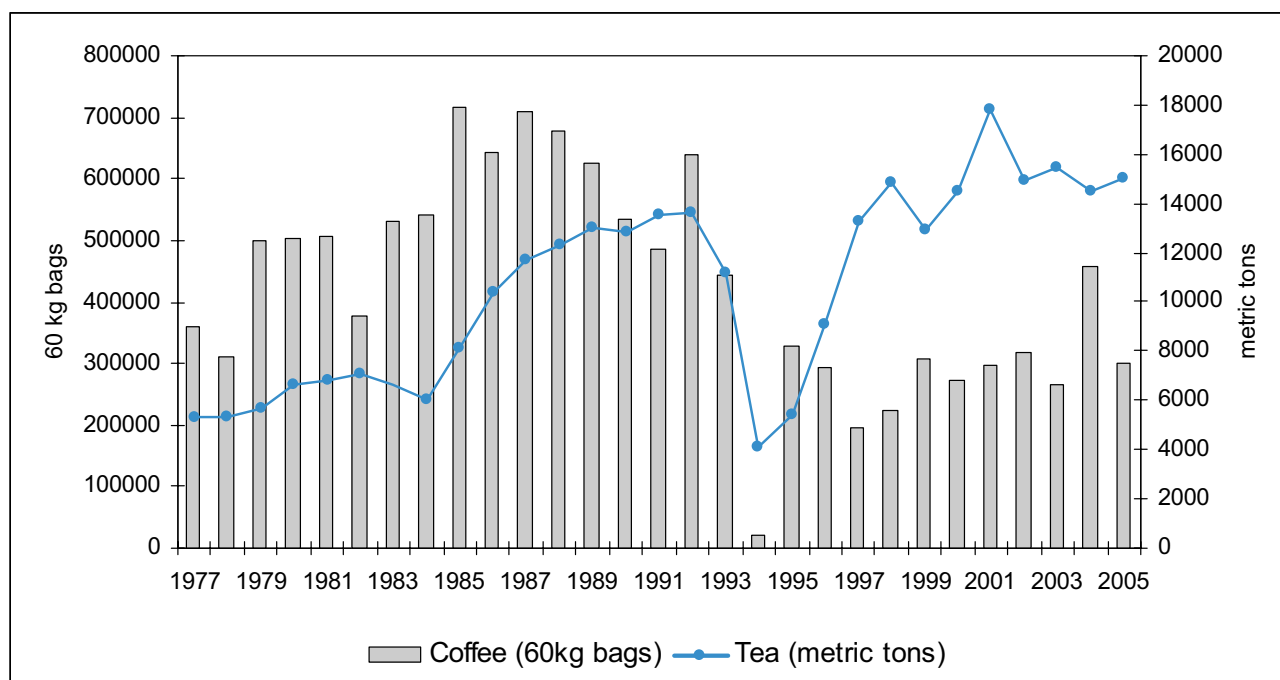
Foreign investors have to date only played a limited role in the tea and coffee sectors. Coffee is produced mostly by small land-owners and there are no major transnational corporations (TNCs) involved in processing or branding Rwandan coffee. The tea sector tends to be organized around larger estates, which are typically partly owned by the State and by a number of smallholders and producers. Foreign involvement is somewhat larger than in the coffee sector, but it remains limited (section B). It could increase in the near future, however, if the Government moves ahead with plans to privatize a number of tea estates.

The industrial sector has evolved little over the past three or four decades. It has not only remained small, but is also undiversified and unsophisticated and has remained on the fringes of global changes in manufacturing (in terms of technologies, modes and organization of production, management, etc). Reflecting the agricultural nature of the Rwandan economy, food processing represents about 80 per cent of total manufacturing activity, which itself accounts for about half of industrial output. Aside from food products, even basic manufactured goods are to a large extent not produced domestically and need to be imported from the region and beyond (section A.3). The other main industrial sector is construction, which has boomed in the past decade, much as a consequence of the need to rebuild public and private infrastructure in the aftermath of the genocide. Foreign investors have not driven the transformation of the industrial sector so far. They could potentially play a larger role in the future, including by introducing new modes and organization of production, management know-how and basic technologies.

Although the share of the services sector in the economy has also stagnated over past decades, it is somewhat more diversified than the industrial sector, spanning retail services, transport, finance, insurance and other core services (public administration, telecommunications and utilities). The depth and breadth of services offered domestically – be it in IT, finance, professional or back-office services – remain well below what is available even in neighbouring countries, however. Foreign investors have played a somewhat

more active role in the services sector than in industry, with investments in banking, tourism, and more recently telecommunications. These investments have had positive impacts, most evidently in ICT where foreign investors are on their way to building high-quality infrastructure (section B), which is essential to the Government’s aim to promote a knowledge-based economy and key to virtually all sectors of the economy.

Figure I.2. Coffee and tea production, 1977-2005
(60 kilo bags and metric tons)



Sources: International Coffee Organization and Food and Agriculture Organization (FAO).

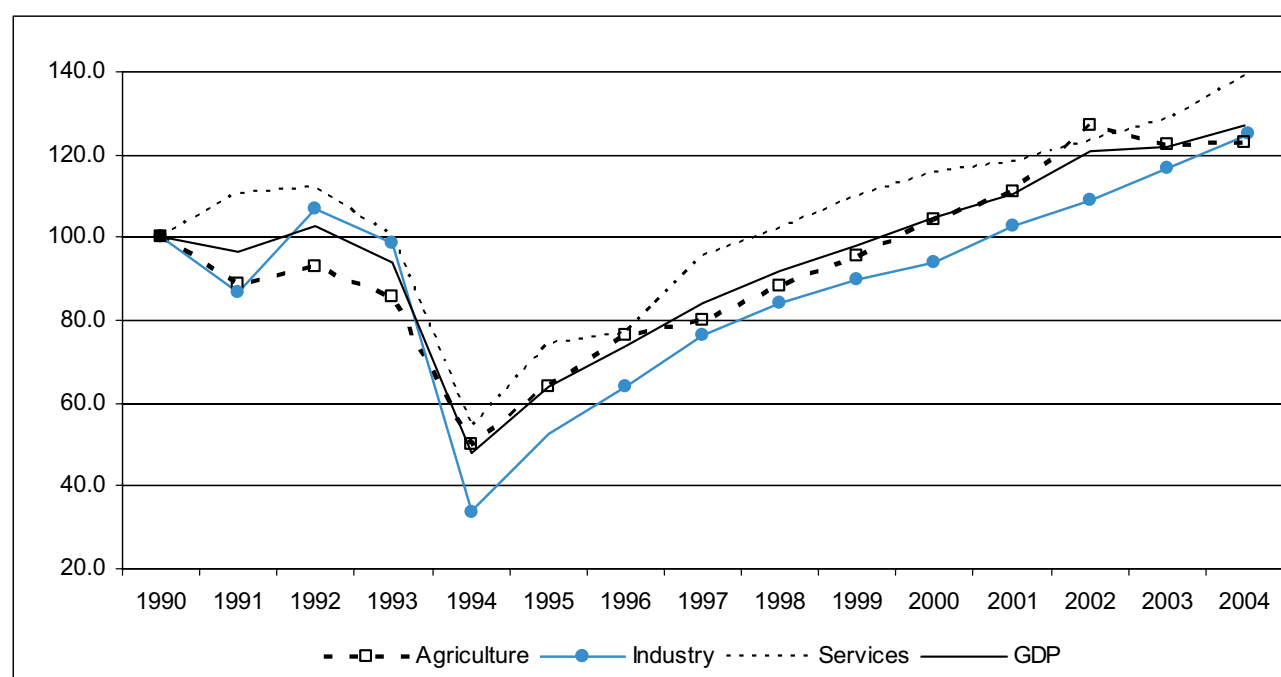
The limited size of the formal sector, both in industry and in services, is illustrated by the small number of companies listed as “large taxpayers” by the Rwanda Revenue Authority (RRA). By RRA’s own account, the list includes “almost all manufacturing companies”, those with complex accounts, those with a turnover in excess of Rwf200 million (\$360 000) and all excisable firms. Even so, the list includes only 268 entities, 30 of which are non-commercial (international organizations, NGOs or parastatals), both in industry and services. Similarly, employment is heavily concentrated in agriculture. Close to 90 per cent of the working-age population works in agriculture (subsistence farming or formal agricultural activities). Public administration and social services employ another 6 per cent of the population, with commerce, hotels and restaurants representing around 3 per cent. Manufacturing, in contrast, employs less than 1 per cent of the working-age population.

2. 1994 and structural reforms

Normal economic activity came to a halt during the genocide in 1994, with real GDP falling to about half its level of the previous years, equivalent to the level of 1970 (figure I.3). All sectors were severely affected, with industrial output contracting most, followed by agriculture. Industry, particularly manufacturing, was affected for a long time as some of the vital backbone infrastructure (electricity and water services) was severely damaged. A good number of establishments were damaged and had to be rebuilt.

Destruction of backbone services occurred to such an extent that the output of electricity, water and gas in 2004 was still 30 per cent below its 1990 level, despite GDP recovering to 27 per cent above its initial level in the same period. The utilities sector suffered both from outright destruction and from a lack of maintenance. Rwanda currently suffers not only from a severe shortage of generating capacity in electricity, but also from poor quality and reliability of supply (outages, technical losses, surges) and high costs. The availability, reliability and cost of electricity are identified by most investors as one of the key constraints in operating conditions and barriers to growth.

Figure I.3. Real GDP by sector, 1990-2004
(1990 = 100)



Source: Banque Nationale du Rwanda.

Export crops were the most affected segment of agriculture, as tea and coffee were mostly not harvested in 1994. The slow recovery in coffee production and falling prices of tea and coffee on international markets further affected value added for cash crops, which represented only 47 per cent of the 1990 level in 2004. Food production, in contrast, was affected to a smaller extent by the genocide and recovered faster, as people sought to harvest their crops despite everything and resumed subsistence farming as quickly as possible.

Government policy played a key role in the recovery of the economy after 1994. One of the most important measures was to ensure that property rights on capital assets, and most crucially on land, were respected. Neither national nor foreign investors faced difficulties in reclaiming movable assets that were seized during the genocide and all were able to resume operations quickly if they wished. It was also determined under the Arusha Peace Agreement that refugees would have the right to repossess their property (including land) upon return, but with a prescription of 10 years. This policy minimized the disruptions generated by the vast movements of refugees (in exile and in return), mostly between 1994 and 2000. It had a major impact on the recovery in food production, but also in ensuring the return of existing foreign investors that had interrupted activity and repatriated foreign staff during the genocide.

The Government also rapidly initiated stabilization policies and a series of structural reforms aimed at reducing poverty through private sector development. A poverty reduction and growth facility (PRGF) was concluded with the IMF to support policy reforms in 1998-2002. It was extended in August 2002 until June 2006, and then again renewed for three years. The initial PRGF focused on re-establishing macro-economic balance and creating appropriate tools and institutions to manage government policy. The IMF provided significant technical assistance in the area of fiscal and monetary policy, financial supervision and collection of statistics.

The second and third PRGF put increased emphasis on structural reforms and private sector development to sustain growth over the medium term. A key measure, already initiated in 1996, is the privatization programme, which has picked up pace in recent years. Much of the focus of the PRGF is also on institutional reforms and capacity-building in administration, and the Government has committed itself to update a number of laws and regulations affecting the investment climate and competitiveness.

Economic and social policy is guided by the Vision 2020 strategy, which the Government elaborated through a wide consultative process with civil society and the international donor community. Vision 2020 defines ambitious goals for the country. It aims to turn Rwanda into a middle-income country by 2020 and achieve the United Nations' Millennium Development Goals (MDGs), with significant improvements in health, education, inequality and other social indicators of development (table I.1). The document provides a sound evaluation of Rwanda's current economic situation, constraints to development³ and challenges for the decades to come (box I.2).

Table I.1. Main targets of Vision 2020 and the Millennium Development Goals

	2000	2010	2020
Real GDP growth (per cent, average)	6.2	8.0	8.0
Industrial sector growth (per cent)	7.0	9.0	12.0
Services sector growth (per cent)	7.0	9.0	11.0
Domestic investment (percentage of GDP)	18.0	23.0	30.0
GDP per capita (\$)	220	400	900
Poverty rate (percentage living under \$1/day)	64.0	40.0	30.0
Off-farm jobs	200 000	500 000	1 400 000
Urban population (percentage)	10.0	20.0	30.0
Population living on agriculture (percentage)	90.0	75.0	50.0
Literacy	48.0	80.0	100.0
Primary to secondary school transition rate (per cent)	42.0	60.0	80.0
Tertiary education rate (per thousand)	1.0	4.0	6.0
Life expectancy at birth	49	50	55
Infant mortality rate (per thousand)	107	80	50

MDGs, selected indicators (by 2015)

1. Halve proportion of people whose income is less than \$1 a day.
2. Achieve universal primary education.
3. Reduce the under-five mortality rate by two thirds.
4. Develop and implement strategies for decent and productive work for youth.

Sources: Ministry of Finance and Economic Planning, Vision 2020 and United Nations.

³ It identifies, among the main constraints: (1) the decrease of soil productivity and land pressure; (2) transport issues and other infrastructure constraints; (3) the narrow economic base; (4) the low level of human development; (5) the lack of entrepreneurship; (6) the poor institutional capacity; and (7) the social and economic consequences of the genocide.

Box I.2. Vision 2020 and the role of FDI

The central goal of Vision 2020 is to “(...) build a modern and prosperous Nation, strong and united, worthy and proud of its fundamental values; politically stable, without discrimination among its sons and daughters; and all this in social cohesion and equity”.⁴ In order to achieve this, Government policy will be centred on: (1) “human resources development and a prosperous knowledge-based economy (...)”; and (2) “the fast development of entrepreneurship and a modern, competitive private sector, based on a culture of initiative and creativity centred on a solid class of businessmen and entrepreneurs, geared towards capital formation through the revitalisation of industry and service sector”.⁵

Vision 2020 defines six pillars:

- The reconstruction of the nation;
- An efficient state capable of uniting and mobilizing its population;
- Human resources development;
- Town and country planning and development of basic infrastructure;
- Development of entrepreneurship and the private sector;
- Modernization of agriculture and animal husbandry.

Economic development is thus expected to be private sector-led, with the Government focusing its efforts on providing key public services (education, health, basic infrastructure) and administration (fair, efficient and predictable legal and regulatory regime, good governance). Aside from defining national objectives, Vision 2020 also clearly identifies the main constraints that need to be addressed:

- The decrease of soil productivity and land pressure;
- Transport issues and other infrastructure constraints;
- The narrow economic base;
- The low level of human development;
- The lack of entrepreneurship;
- The poor institutional capacity;
- The social and economic consequences of the genocide.

This Review envisages that FDI could play a highly relevant role in helping Rwanda achieve the Vision 2020 goals. In particular, measures are proposed for FDI to contribute to: (1) human resources development and the transfer of skills; (2) the creation of a knowledge-based economy; (3) the development of entrepreneurship and a competitive private sector; (4) widening the economic base; and (5) improving infrastructure.

Source: Vision 2020, Ministry of Finance and Economic Planning.

⁴ Vision 2020, November 2002, p.7.

⁵ Vision 2020, November 2002, p.7.

In order to achieve the Vision 2020 goals, the Government estimates that the economy should grow by about 8 per cent per year. This would require domestic investment to increase to 25 per cent of GDP by 2010, and 30 per cent by 2020. It also recognizes that a significant increase in FDI would be necessary in order to achieve such investment rates. While good progress has been achieved since the elaboration of the Vision 2020 strategy, the challenges to attain the vision remain enormous. A well-defined strategy to integrate FDI into the national development policy agenda – including FDI attraction and promotion strategies – is still to be elaborated. Chapters II and III of this Review make suggestions in that direction.

The Government's sound track record of reforms over the past decade has generated strong support from the international community, which has further contributed to the progress towards Vision 2020 goals. While much of the assistance in the immediate aftermath of 1994 focused on emergency relief, aid flows are increasingly aimed at policy and structural reforms, infrastructure and capacity building (table I.2). Such flows could in the future also be leveraged to a greater extent to promote private sector development, including through home-country measures to promote FDI (chapter III). The good record of reforms also allowed the Government to secure debt relief under the enhanced heavily indebted poor countries (HIPC) initiative. Debt relief was completed in April 2005, and Rwanda was pledged additional cancellation of debts owed to multilateral organizations (IMF, World Bank, African Development Bank) under the G-8 initiative of June 2005. Sustained private investment flows are becoming more and more important to the achievements of the Vision 2020 goals, however.

Table I.2. Structure of ODA disbursement commitments
(Percentage of total, period average, OECD-DAC reporting countries)

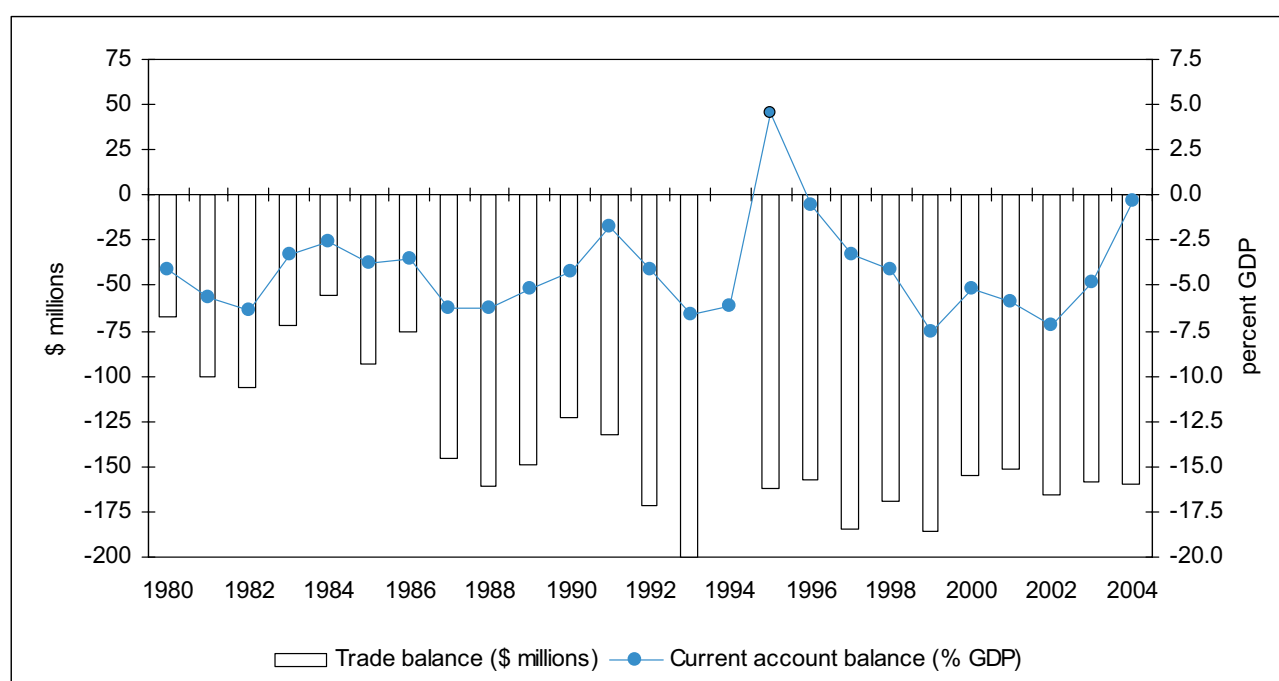
	1991-1994	1995-1998	1999-2002	2003-2004
Social infrastructure & services	13.7	26.7	34.8	36.5
Education	3.1	5.6	7.6	2.6
Health	1.0	4.3	4.7	2.5
Government & civil society	1.0	8.2	13.6	18.1
Other	8.7	8.7	8.9	13.3
Economic infrastructure	22.7	5.9	6.8	15.8
Transport & storage	11.6	4.4	4.5	10.3
Energy	7.0	1.0	0.1	3.7
Other	4.0	0.5	2.2	1.7
Production sectors	9.9	1.9	13.9	18.0
Multi-sector	10.1	4.4	3.8	9.1
Other (emergency, NGOs, ...)	43.7	61.0	40.6	20.6
Memo:				
Total commitment (\$ millions)	238.5	291.9	341.5	272.8

Source: OECD, CRS database.

3. External sector

The minute export capacity, the dependence of the formal sector on imported goods, the low domestic saving rate and the need to rebuild the economy after 1994 have generated large trade and current account deficits over the past decades (figure I.4). This has increased Rwanda's reliance on sources of external financing and made its economy vulnerable to external shocks, both arising from terms of trade or from the availability of aid flows. The current account deficit averaged \$81 million a year over the past two decades, or 4.1 per cent of GDP.

Figure I.4. Trade and current account balances, 1980-2004
(Millions of dollars and percentage of GDP)



Source: IMF, International Financial Statistics.

Rwanda's merchandise exports averaged \$75 million per year in 2002-2004, around 4 per cent of GDP, which is small even compared to other LDCs. The export base is extremely concentrated as tea, coffee and a few minerals (mostly colombo-tantalite) account for over 80 per cent of total exports (table I.3). So far, Rwanda has also not been able to provide much value-addition in the tea and coffee sectors, as it is essentially an exporter of unprocessed bulk products, with little local transformation and branding. Other exports consist mostly of primary products as well, or of re-exports to the region, essentially Burundi and the Democratic Republic of the Congo. Although Rwanda, together with Uganda, is well positioned to serve as a trading platform in the eastern part of the Democratic Republic of the Congo, persistent instability in the area and tensions between the two countries have affected trade flows. In the mining sector, a joint venture between an Egyptian investor and Rwandan partners has become one of the largest producers and exporters of coltan.

The formal sector relies heavily on imports for consumer, intermediate and capital goods as a result of the limited offer of domestically-produced manufactured goods. Merchandise imports are typically three to four times bigger than exports, with consumer goods representing about half of the total. Although

much of the population has direct access to very little, if any, imported goods, imported consumer goods in Kigali and a few other major cities are predominant. This is the case even for basic consumer goods,⁶ as domestic productive capacity is extremely limited. Most inputs in industry and virtually all capital goods are also imported.

Table I.3. Structure of trade, 1993-2004
(Millions of dollars, period average)

	1993-1995	1996-1998	1999-2001	2002-2004
Exports	60.1	89.4	72.1	75.0
Primary products	37.5	47.3	44.1	44.3
(Coffee)	(32.7)	(38.8)	(24.0)	(20.6)
(Minerals)	(2.3)	(3.5)	(19.4)	(19.5)
(Other)	(2.5)	(4.9)	(0.7)	(4.2)
Processed goods	9.6	18.4	21.2	23.5
(Tea)	(9.6)	(17.2)	(19.6)	(22.0)
(Other)	(0.0)	(1.2)	(1.6)	(1.6)
Re-exports and others	12.9	23.7	6.8	7.2
Imports	230.6	284.3	285.6	263.0
Consumer goods	105.1	129.9	155.4	137.2
Equipment goods	47.4	59.0	37.9	43.7
Intermediate goods	54.8	64.0	44.3	41.3
Fuel and lubricants	23.3	31.4	48.1	40.9

Source: Banque Nationale du Rwanda.

Although the shortage of domestic suppliers is less acute in the services sector than in manufacturing, services imports are also significant, in part due to large imports of transport services resulting from the fact that it is a landlocked country. Rwanda faces one of the highest shares of imported freight services as a proportion of the FOB value of imported goods in the world. Imported freight costs averaged close to 23 per cent of the value of FOB merchandise imports in 1999-2003, compared to 8.4 per cent in Africa and 4.5 per cent in Asia (table I.4). Uganda, which is in a similar situation, faced a more moderate share of 16.7 per cent in the same period, while landlocked Lesotho's share was below 4 per cent. Although this high cost clearly raises the price of imported goods and is detrimental to the export sector, it also grants existing or potential domestic producers a fair degree of natural protection, particularly for low-value and high-volume goods.

⁶ Including soaps, textiles and garment, food products, tools and others.

Table I.4. Imported freight services, 1994-2003
(Percentage of value of imports, FOB, period average)

	1994-1998	1999-2003
Rwanda	16.7	22.7
Africa	8.6	8.4
Asia	5.2	4.5
China	6.6	4.1
Kenya	12.3	8.1
Lesotho	3.8	3.9
South Africa	5.7	6.1
United Republic of Tanzania	14.8	11.0
Uganda	23.4	16.7

Source: IMF, Balance of Payments Statistics.

4. Human resources and demographic structure

Human resources and demographic factors are important determinants of the constraints and opportunities for domestic and foreign investors in Rwanda. They are also key factors to sustainable development and national reconciliation. The general shortage of technical expertise and entrepreneurship is in good part responsible for the low level of national investment and the under-developed state of the manufacturing and services sectors. It also imposes constraints on the type of FDI that Rwanda can hope to attract in the medium term and delineates areas where foreign investment can contribute most in achieving national development goals.

a. Demographic structure

Rwanda's population was decimated during the genocide in 1994, when around 800 000 people were killed. The defeat of the Forces Armées Rwandaises by the Front Patriotique Rwandais (FPR) led to the temporary displacement of about 2 million people, who fled mostly to the Democratic Republic of the Congo before returning in their majority to Rwanda over the past few years. A large number of long-term exiles also returned to Rwanda from Uganda and other neighbouring countries.

The total population in 2003 was estimated at 8.4 million people (table I.5). Rwanda still has among the highest fertility and population growth rates in the world. As a result, it has a very young population, with close to half the people below the age of 15, three quarters below the age of 30 and the dependency ratio near unity (figure I.5). The genocide also left a large number of orphans and households headed by widows.

Table I.5. Demographic indicators, 1993-2003

	1993	1995	1998	2003
Total population (millions)	7.6	5.7	7.3	8.4
Rural population (percentage of total)	94.5	94.3	94.0	93.6
Population density (per square km)	308.4	230.9	295.3	340.3
Population 0-14 (percentage of total)	47.3	47.1	45.0	45.7
Population 15-64 (percentage of total)	50.3	50.6	53.0	51.3
Population above 65 (percentage of total)	2.4	2.3	2.0	3.0
Age dependency ratio	0.97	0.95	1.02	0.95
Malnutrition (percentage, children under 5) ¹	29.4	27.3	..	24.3
Life expectancy at birth (years) ¹	34.8	40.5	40.0	39.8
Mortality rate, adult female (per 1 000) ^{1,2}	408.6	..	..	599.0
Mortality rate, adult male (per 1 000) ^{1,2}	493.1	..	..	667.0
Mortality rate, infant (per 1 000) ^{1,3}	103.0	124.0	118.0	118.0

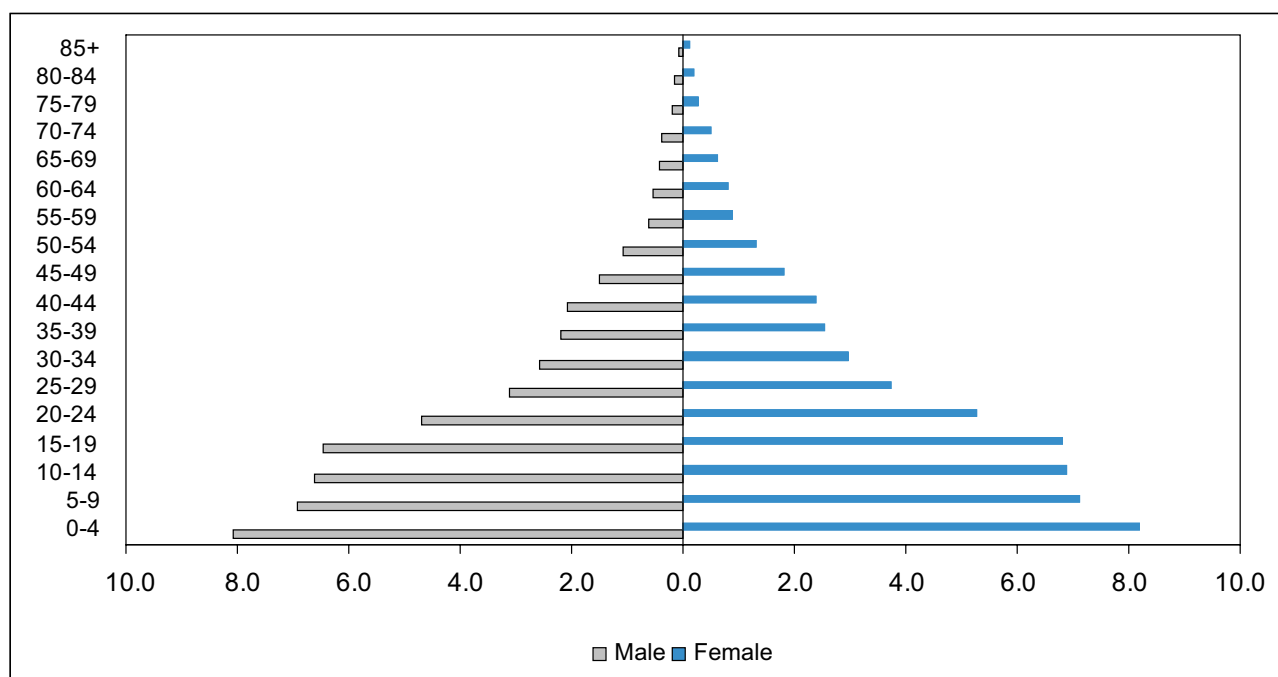
¹ Nearest available year.

² Defined as the probability of dying between the age of 15 and 60, if subject to current age-specific mortality rates.

³ Defined as the number of infants dying before reaching the age of one, per 1 000 live births.

Source: World Bank, World Development Indicators.

Figure I.5. Age pyramid, 2002
(Percentage of total population by age group, male - female)



Source: Rwanda Development Indicators, Ministry of Finance and Economic Planning.

The predominance of the agricultural sector in the economy highlighted earlier is also reflected in the extremely high proportion of the population living in rural areas, about 90 per cent of the total. Kigali is the only major city, with a total population estimated at around 600 000, and it concentrates the majority of the country's urban population and infrastructure. The density of population is also one of the highest in Africa, at par with a number of significantly more urbanized and industrialized countries. As a result, pressure on rural land has persistently increased over the past decades. Limits on the availability of land and on labour productivity in agriculture make it essential for poverty reduction and sustainable development that a rising share of the population find productive employment in the secondary and tertiary sectors, and that Rwanda move towards a more urbanized society. This makes labour intensive investments, domestic and foreign, all the more crucial for the coming decades.

b. Education and skills

Although it is difficult to evaluate precisely the impact of the genocide on the level and availability of skills, there is no doubt that the consequences were grave and lasting. Some of the killings specifically targeted intellectuals as well as business leaders and entrepreneurs. Additionally, the exile of about 2 million people following the victory of the FPR affected not only people in the countryside, but also a large number of people in public service and business. The country's administrative system was thus left in shambles, with physical destruction of archives and infrastructure adding to the human cost.

Returning long-term exiles from neighbouring countries also came with skills, however, and a number of them had been educated or trained in Uganda, the United Republic of Tanzania, Kenya or other neighbouring countries. A more limited number of exiles from further afield in Europe or North America also returned with capital and skills. The majority of long-term exiles returned as English speakers (in addition to Kinyarwanda). As a result, English has become Rwanda's third official language together with Kinyarwanda and French. Although the majority of the population, including people with formal education, is not fluent in both French and English, the Government has initiated efforts to ensure at least basic education in the three languages in all schools. Progress in that direction has been hindered by the lack of qualified trilingual teachers, however.

The shortage of skills and qualified people remains a major constraint to investment and development in all fields, even though significant progress has been achieved in the past decade. The adult literacy rate increased to about 70 per cent in 2002 from 57 per cent a decade earlier (table I.6). Similarly, the youth literacy rate rose from 76 per cent in 1993 to 85 per cent in 2002, partly as a result of the introduction of six years of compulsory schooling and high enrolment ratios in primary schools. The transition from primary to secondary school and higher education remains the privilege of a few, however, with gross enrolment ratios in 2002 of 16 per cent and 2.5 per cent in secondary and tertiary schools, respectively. As a result, shortages of technical and higher skills are slow to resorb.

A recent World Bank study⁷ indicates that around 13 000 students were enrolled in higher education in 2000, equivalent to less than 1 per cent of the population between 20 and 29 years of age (table I.7). Although this is a significant increase from a few years earlier, it remains well short of Rwanda's skills needs for private sector development (technical or managerial employees in the formal sector and entrepreneurship) and public administration (civil service, education, health). About 32 per cent of students in higher education studied economics and management, 19 per cent were in literature and humanities, and only around 13 per cent chose law or science and technology.

⁷ World Bank (2004).

Table I.6. Education indicators, 1993-2002

	1993	1995	1998	2002
Literacy rate, adult (per cent of total)	57.3	60.2	64.3	69.2
Literacy rate, youth (per cent of total)	76.2	78.6	81.5	84.9
Compulsory education (years)	6	6
Primary school, gross enrolment ratio	118.6	122.0
Secondary school, gross enrolment ratio	11.1	16.1
Tertiary school, gross enrolment ratio	0.9	2.5
Percentage of trained teachers, primary	48.6	81.2
Percentage of trained teachers, secondary	83.9
Pupil to teacher ratio, primary	54.3	59.9
Pupil to teacher ratio, secondary	26.8
Pupil to teacher ratio, tertiary	13.8	15.1

Sources: UNESCO and World Bank, World Development Indicators.

The shortage of technical skills and competences extends to all walks of economic and public life, from accountants to lawyers, judges to teachers, mechanics to civil servants, etc. It is particularly acute as well when it comes to entrepreneurship, as is illustrated by the very low level of national investment. The latter can indeed be attributed not only to the low level of domestic saving, difficult access to finance and limited ability to self-finance projects, but also to weaknesses in entrepreneurial tradition and skills and the ability to identify opportunities and set up well documented business plans. Skill-intensive FDI and measures to transfer know-how to nationals could thus make a significant contribution to Rwanda's development and address one of its key weaknesses.

Table I.7. Higher education indicators, 1980-2000

Enrolment (number of students in higher education)	
1980	1 243
1990	3 389
1995	4 597
2000	12 757
Enrolment by field of study (per cent)	
Literature and humanities	19.2
Law	12.4
Economics and management	31.9
Science and technology	13.9
Health sciences	8.3
Agriculture	5.4
Teacher education	9.0

Source: World Bank (2004).

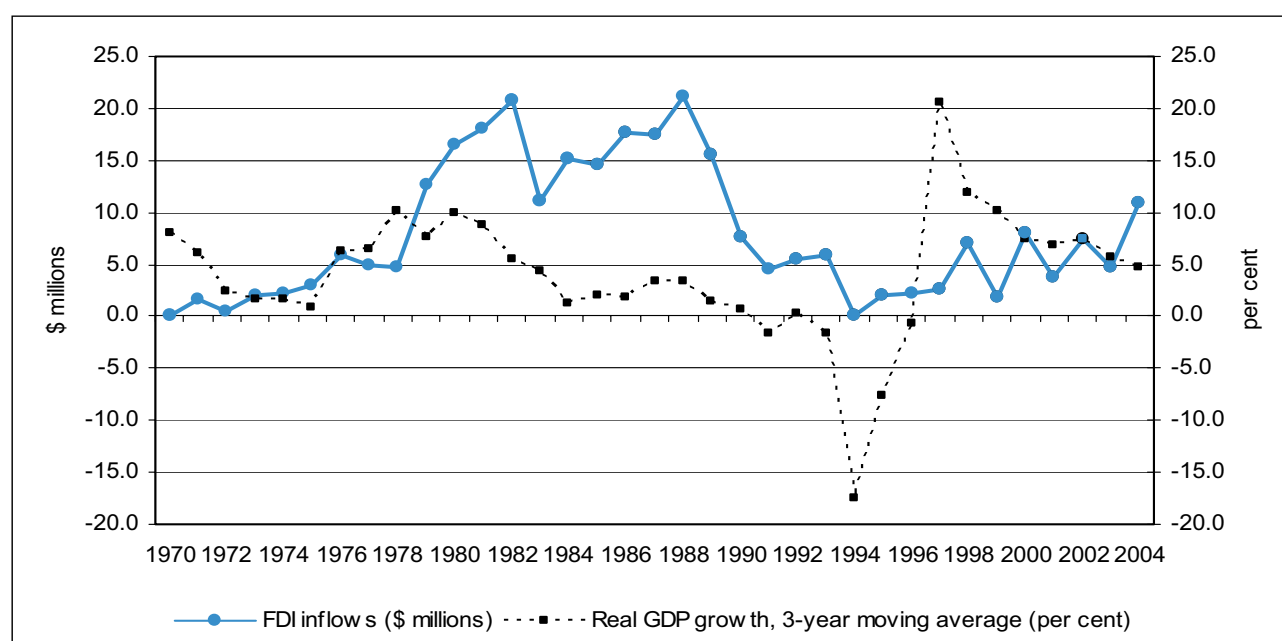
B. FDI trends

I. FDI size and growth

Rwanda has never attracted large amounts of foreign direct investment (FDI) at any time since independence, and it benefited from very little infrastructure and industrial investment by the colonial powers before that. The small size of the economy, its rural nature, the low level of human capital, the poor quality of infrastructure and landlocked position, high operating costs and limited proved natural resources mean that Rwanda lacks the main drivers of foreign investment by major transnational corporations (TNCs) that may be in search of resources, markets or internationally competitive centres of production.

Net FDI inflows averaged about \$4 million a year in the 1970s. They picked up towards the end of the decade and reached an average \$17 million per year in the 1980s, as more liberal policies fostered higher real GDP growth and generated additional investment opportunities (figure I.6). The bulk of these investments was in agribusiness, banking and tourism. Some of the larger investments included the purchase of the local brewery Bralirwa by Heineken and the participation of Belgolaise (part of the Fortis Group) in Banque de Kigali.

Figure I.6. Net FDI inflows to Rwanda and real GDP growth, 1970-2004
(Millions of dollars and per cent)



Sources: UNCTAD, FDI/TNC Database and World Bank, World Development Indicators.

The deteriorating economic performance towards the end of the 1980s and early 1990s, together with the re-emergence of ethnic tensions and political instability, sharply cut FDI flows well before the genocide in 1994. Inflows then came to a halt with the genocide and the collapse of society and the economy. In addition to the human disaster, the genocide led to the deterioration or destruction of much of Rwanda's capital infrastructure, and output collapsed back to the level of 1970. Normal economic activity stopped for several months, and most foreign investors suspended their operations and repatriated foreign staff.

Although no comprehensive data are available, it appears that the majority of the larger foreign firms present in Rwanda before 1994 did not divest as a consequence of the genocide and the destruction it brought about. This is the case, for example, of Heineken, which quickly resumed operations and reinvested in Bralirwa. Similarly, Belgolaise (Fortis Group) maintained its investment in Banque de Kigali, and Sabena Hotels quickly refurbished the Hôtel des Mille Collines.⁸ The Government policy to secure the property rights of owners upon their return contributed to this favourable outcome.

Although the genocide does not appear to have led to a wave of divestments by the few larger foreign investors present in Rwanda before 1994, FDI flows have remained minimal over the past ten years, despite the sound economic policies and structural reforms put in place by the new Government. Rwanda has thus completely missed out on the global surge in FDI flows to developing countries that started in the 1990s and peaked in 2000.

Political and military instability in the region, partly generated by the large number of Rwandan refugees in the Democratic Republic of the Congo and the issue of their return home,⁹ and the indelible impact of the genocide have severely affected Rwanda's image abroad and put a major brake on new investments by companies or people unfamiliar with the region. Despite the huge progress in the past decade in achieving social, economic and political stability and in improving security and investment conditions, Rwanda continues to suffer from a large "image gap". This gap between the reality on the ground and perceptions abroad is vast, but it is usually bridged upon the first visit. There is thus significant potential for "image improvement" initiatives (chapter III), and positive developments in the current constitutional and electoral process in the Democratic Republic of the Congo could also help improve the perception of the Great Lakes region in general.

Other countries in the region and elsewhere have managed to overcome such image problems in the recent past as they came out of civil conflicts. FDI flows to Mozambique picked up in the early 1990s, very soon after pluralism and political stability were established under the constitution of 1990 and the Rome General Peace Accords of 1992 (figure I.7, vertical lines indicate approximate year when stability was achieved). Mozambique also had to deal with a large number of refugees and internally displaced people and needed to establish political stability after several decades of fighting between the FRELIMO-led Government and RENAMO.

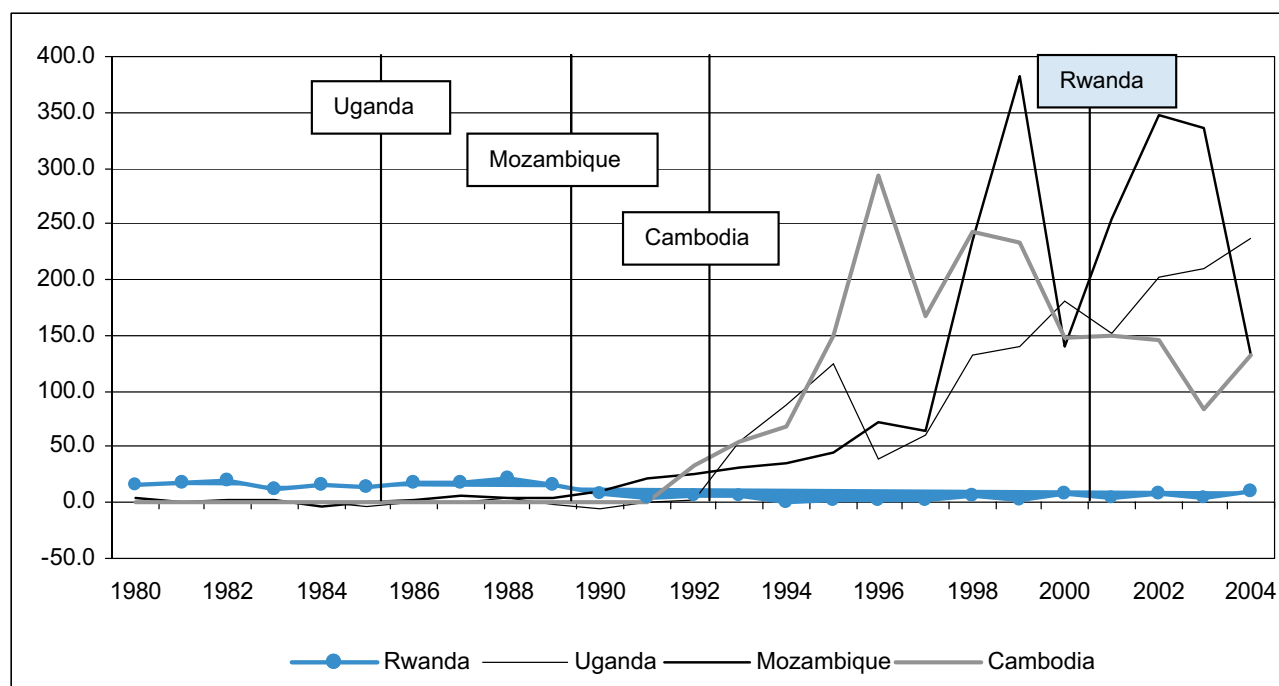
The rapid increase in FDI in Mozambique is partly explained by the close proximity with South Africa. South African investors significantly contributed to the success of the Maputo Corridor, which quickly brought quality infrastructure (road and railway links to South Africa's industrial heartland, connection to South Africa's electricity grid, sea port) and developed around one main investment, the MOZAL aluminium plant. Measures to establish modern regulations in key backbone services (transport, utility, telecommunications) and to allow private investment in these sectors were also instrumental in the success of the Corridor and the attraction of FDI, however. As a result, Mozambique has attracted significant

⁸ Fortis Group decided to withdraw from Belgolaise in 2005 as part of a company-wide strategy. Fortis failed to identify a suitable group to take over the whole Belgolaise network (comprising banks in 10 countries in Africa) in a single deal and decided to liquidate its activities or integrate them in Fortis Bank. In 2005 also, Mikcor Hotel Holding, owned by a Rwandan from the Diaspora, bought the Hôtel des Mille Collines from Sabena Hotels.

⁹ Close to two million people fled Rwanda to the Democratic Republic of the Congo and other neighbouring countries as the Front Patriotique Rwandais (FPR) took control of the country. The presence among them of a large number of people from the Interahamwe militia and the Forces Armées Rwandaises responsible for the genocide and determined to resume fighting was at the source of much of the instability in the region and delayed the return of civilian refugees to Rwanda.

FDI inflows over the past decade, not only in resource extraction, but also in industry, agriculture, agro-processing, banking and tourism.

Figure I.7. Net FDI inflows to Rwanda, Cambodia, Mozambique and Uganda 1980-2004
(Millions of dollars)



Note: vertical lines indicate the approximate year stability was firmly established.

Source: UNCTAD FDI/TNC Database.

Similarly, Cambodia attracted FDI inflows soon after a formal ceasefire was signed in 1991 and elections were held in 1993. Inflows focused on the wood industry, textiles, and tourism. As is recurrent in post-conflict countries, investors originated mostly from neighbouring countries, as they are likely to have a deeper understanding of the socio-political situation and investment opportunities in difficult conditions.

In contrast, it took a longer period of reforms and political stability for FDI flows to resume in Uganda. Inflows resumed around 1993, eight years after Milton Obote was overthrown and reforms were introduced by President Museveni. As in Cambodia and Mozambique, a large proportion of foreign investors originated from the region, particularly Kenya and South Africa.

In Rwanda, small amounts of net FDI flows resumed immediately after 1994. Existing foreign investors injected some new capital to resume operations. A limited number of new investors were also attracted, in good part as a result of the privatization programme launched in 1996. Most new investors were familiar with the region, however, which allowed them to see opportunities beyond the image problem. In many respects, Rwanda shares more similarities with Uganda than with Cambodia or Mozambique, and this has translated into a delay in the resumption of FDI inflows. In particular, both countries face constraints owing to their landlocked nature and the low quality of transport infrastructure (roads, rail, and ports) in neighbouring Kenya and the United Republic of Tanzania. They have also suffered from the impact of conflicts and instability in the Great Lakes region as a whole.

Net annual FDI inflows to Rwanda averaged \$3.1 million in 1995-1999 and \$7 million in 2000-2004, and are on a moderate rising, but erratic, trend. The erratic nature of the flows is the consequence of the role of the privatization programme in generating FDI and the small overall amounts, which can be significantly affected by single investments. Although FDI cannot be said to have taken off so far, there are encouraging signs of rising interest by potential investors, partly as a result of the improvement in the investment framework and the Government's efforts to promote FDI, including through the creation of the Rwanda Investment and Export Promotion Agency (RIEPA) in 2000. Arguably, the socio-political situation can also be said to have been genuinely stabilized only since the return and re-settlement of the majority of refugees around 2000.

The single largest new investment in recent years is MTN's (South Africa) acquisition of a 40 per cent share in MTN-Rwandacell. The company acquired the first mobile telecommunication licence in 1998 and started operation within a few months, rapidly extending coverage to about 75 per cent of the population by mid-2005. Another significant new investment was made by US-based investors who set up Terracom, initially as an internet service provider (ISP). The company recently started to expand its services by laying fibre optic cable in Kigali and across the provinces and it bought Rwandatel, the national telecommunication operator, in June 2005 in the largest privatization operation to date. Rwandatel was sold, together with a mobile telephony licence for \$20 million, including \$5 million in cash upon signature and \$15 million in cash payments over the following 10 years.

The involvement of foreign investors such as MTN and Terracom in the ICT sector has been instrumental in the Government's strategy to develop a knowledge economy and has facilitated business in general. MTN-Rwandacell's extensive coverage of the territory allows rural areas without fixed-line telephony to have access to telecommunications services. The company has also made efforts to transfer skills to its national staff, which currently represents 98 per cent of the total. In turn, Terracom's investments in setting up a fibre-optic network will help interconnect Rwanda's regions, promote e-governance and provide fast and efficient ICT infrastructure throughout the country. Terracom will also launch its mobile phone services in 2006, which should introduce competition into the market and further promote the expansion and quality of ICT services.

The pre-eminence of foreign investments in mobile telecommunication in the early stages of reconstruction is a general trend in post-conflict countries. These were the first types of investments to occur in a number of countries, including Afghanistan, the Democratic Republic of the Congo, Sierra Leone, Somalia, Sudan, and Uganda. A number of factors explain this, including: (1) the initial capital investment can be relatively modest and is located in more protected urban areas; (2) a return on investment can be generated relatively quickly, in many instances as quickly as two to three years; and (3) company cash-flow is aided by the predominance of pre-paid contracts, which also avoid payment problems. The relatively moderate complexity of technology required to set up mobile phone networks also implies that small entrepreneurs (including in several instances from the Diaspora) willing to take on a fair degree of risk are able to invest where larger multinationals would not.

The privatization programme has been the major channel to attract FDI into Rwanda since its inception in 1996. Although it took a few years to take off, the programme had led to the partial or full privatization of 40 enterprises by October 2005, out of a list of 68 companies identified for sale. A small number of non-viable companies have also had their assets liquidated (table I.8).

FDI inflows through the privatization programme amount to \$37 million so far.¹⁰ Aside from the recent Rwandatel operation mentioned above, six asset sales have generated the bulk of the flows. The second largest privatization so far was the sale of 80 per cent of the capital of Banque Commerciale du Rwanda (BCR) to Actis, a company fully owned by the CDC Group, itself owned by the United Kingdom's Department for International Development (DFID). The third largest privatization was the sale of 80 per cent of the capital of Banque Continentale Africaine (BACAR) to a consortium of Fina Bank (Kenya) and Enterprise Holding (Botswana). The other major operations were the sale of a tea estate to Lab International (United Kingdom), of the national tobacco company to a Belgian investor, of a sugar company to the Madhvani Group (Uganda) and the liquidation of state-owned petrol stations to Shell (United Kingdom).¹¹

Although it did not generate any injection of capital by foreign investors, the Government contracted Southern Sun (South Africa) in 2003 to run the InterContinental hotels in Kigali and Gisenyi, which were refurbished with public funds. While the management contract covered a 15-year period, fees-related issues led Southern Sun to withdraw in 2006. Management of the hotel is currently overseen by Prime Holdings, a government-owned investment vehicle. Full privatization of the hotel is now envisaged and the Serena Group is reported to have expressed interest.

Lahmeyer International (Germany) was also contracted in 2003 to run Electrogaz, the public monopoly electricity and water company, for a five-year period. While it is still too early to assess the impact of Lahmeyer's takeover of the management of Electrogaz, the purpose of the sub-contracting is to generate transfers of skills and competence, and to prepare the company for full or partial privatization.

Since it began operating in 2000, RIEPA has registered 58 investment projects by foreign investors, of which 39 have become operational. Of the latter, 27 represented new investments and 12 involved restructuring, rehabilitation or expansion of existing investments, for a total amount of about \$65 million.¹² Reflecting the size of Rwanda's economy, close to 70 per cent of operational investment projects registered by RIEPA involve amounts below \$1 million, and only one project exceeds \$10 million.

The historically limited involvement of foreign investors in the economy and the time it is taking to rebuild the country's image following the genocide imply that Rwanda is one of the countries in the world that is attracting the smallest amounts of FDI in relative terms. While FDI flows have recovered somewhat since 1994, Rwanda attracted less than \$1 of FDI per capita per annum on average in 2001-2004, compared to about \$12 on average for LDCs and \$39 for developing countries (table I.9). Similarly, foreign investment has contributed only very modestly to total investment, as it represented only 2 per cent of gross fixed capital formation on average in 2001-2004, compared to almost 20 per cent in LDCs and 10 per cent in developing countries.

At the same time, investment by nationals is small as a consequence of the low domestic saving rate, difficult access to finance and a shortage of skills and entrepreneurship. Domestic investment averaged about 16 per cent of GDP in 2000-2003, with the construction sector accounting for close to 90 per cent of the total and equipment goods for the rest. While reconstruction efforts in the aftermath of the genocide partly justify this, the small amount of investment in equipment highlights the slow build-up in productive capacity.

¹⁰ Counting the total amount of \$20 million for the sale of Rwandatel, even though cash payments are to spread over ten years.

¹¹ Shell sold these assets to Kenya Oil Company in 2005.

¹² RIEPA registers amounts planned over several years covering the investor's business plan, not actual amounts invested in any given year.

Table I.8. Privatization programme, 1996-2005
(Millions of dollars and number of firms)

Sector	Amount sold to locals	Number of firms	Amount sold to foreigners	Number of firms
Sold				
Tea and coffee	1.69	4	1.06	1
Fishing	0.29	3	0	0
Livestock/breeding	0.03	3	0.08	2
Agro-processing	0.88	6	3.07	3
Mining	1.27	1	0.29	1
Manufacturing	1.98	4	0	0
Energy	0	0	2.11	1
Tourism	0.37	5	0.18	1
Banking/insurance	0	0	9.81	2
Telecommunications	0	0	20.00	1
Other	0.01	1	0	0
TOTAL	6.52	26	36.6	12
Management contracts				
Tourism	0	0	--	2
Energy	0	0	--	1
Preparatory phase				
Tea and coffee		7		
Fishing		1		
Livestock/breeding		1		
Agro-processing		6		
Mining ¹		1		
Manufacturing		3		
Tourism		2		
Banking/insurance		3		
Other		3		

¹ The Régie des Mines (Redemi) is listed as one company to be privatized. Its mining concessions will be sold separately, however.

Source: Secrétariat National de la Privatisation.

Past trends also indicate, however, that foreign investment could in the future contribute significantly more to business development, the transformation of the economy and wealth creation. Recent foreign investments, including in ICT and banking, provide encouraging signs.

Table I.9. Comparative FDI flows with selected countries, 1986-2004
(Dollars and percentage)

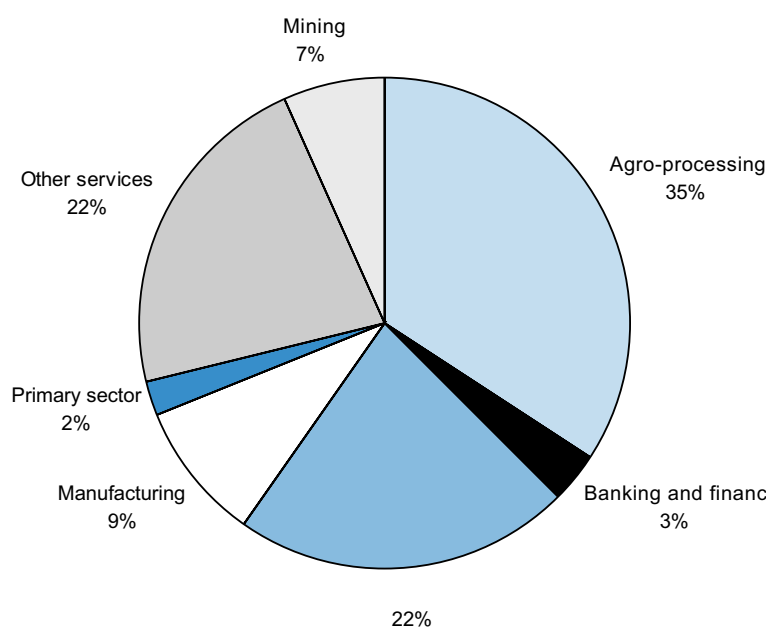
Country	Absolute performance				Relative performance														
	Annual FDI inflows			FDI stock	FDI inflows						FDI stock								
	Millions of dollars				Per \$1000 GDP (\$)						Percentage of gross fixed capital formation								
	1986-1990	1991-1995	1996-2000	2001-2004	2004	1986-1990	1991-1995	1996-2000	2001-2004	1986-1990	1991-1995	1996-2000	2001-2004	Per capita (\$)	2004	Percentage of GDP			
Rwanda	15.9	3.6	4.3	6.7	279.2	2.3	0.6	0.6	0.8	7.1	1.9	2.4	3.9	6.2	1.5	1.5	2.0	31.4	15.1
Benin	25.1	44.3	31.8	40.5	291.2	4.9	8.0	4.6	5.2	15.2	22.8	13.9	12.7	11.8	16.1	7.3	6.3	35.6	7.1
Burundi	1.2	0.7	2.8	0.8	50.6	0.2	0.1	0.4	0.1	1.0	0.7	3.8	1.1	0.7	0.6	5.2	0.8	6.9	7.5
Cambodia	..	76.7	217.1	127.5	2089.8	..	6.9	17.9	9.5	..	26.8	66.3	33.6	..	22.9	46.1	14.7	151.5	47.2
Dem. Rep. Congo	-14.8	-1.1	15.2	314.3	1874.3	-0.4	0.0	0.3	5.7	-1.8	-0.5	2.7	50.9	-1.3	0.1	2.1	37.7	33.6	28.7
Kenya	38.4	12.8	50.4	59.6	1222.7	1.7	0.5	1.7	1.8	4.7	1.5	4.8	4.5	2.4	0.8	3.1	3.5	36.5	7.8
Mozambique	5.0	32.0	178.5	267.9	2165.7	0.4	2.1	10.3	14.3	2.1	14.8	47.8	69.5	0.7	6.7	22.5	35.6	111.5	39.0
U.R. of Tanzania	0.3	46.4	260.4	473.4	5203.3	0.0	1.5	7.7	12.9	0.1	10.3	31.5	47.4	0.1	4.4	19.8	25.6	138.3	48.0
Uganda	-1.0	54.2	110.7	200.5	1612.9	-0.1	2.7	4.8	7.6	-0.3	11.1	18.3	32.1	-0.2	6.9	9.9	15.4	58.0	23.6
Sub-Saharan Africa	1644.0	3259.0	7008.1	13350.4	154608.9	3.4	5.8	11.0	18.8	6.3	10.2	20.0	34.2	3.8	6.6	12.0	19.7	210.5	29.6
COMESA	1401.4	1595.0	3316.4	5699.6	61175.8	5.5	5.2	9.5	14.8	12.4	13.0	19.6	32.0	4.3	8.0	10.6	17.4	153.8	32.1
LDCs	634.2	1586.5	3885.3	8552.0	71952.5	1.4	2.8	6.0	11.9	4.5	9.3	20.1	33.6	2.1	6.0	10.4	19.8	97.0	24.4
Developing countries	27633	80385	203164	193234	2232867	7.1	18.5	43.2	38.5	8.9	16.5	32.2	26.9	3.6	6.5	12.4	10.4	435.8	26.4

Source: UNCTAD FDI/TNC Database (WIR 2005)

2. Distribution by sector and industry

Foreign investment projects¹³ registered by RIEPA between 2000 and March 2005 show a significant concentration in agro-processing, information and telecommunication technologies (ICT) and “other services”, which include hotels and restaurants and other basic services¹⁴ (figure I.8). These three broad sectors alone represent 80 per cent of FDI projects in terms of proposed invested amounts. This is a reflection both of the needs and opportunities of the Rwandan economy. Opportunities in manufacturing remain limited as demand for manufactured goods is small and production costs are high, even compared with neighbouring countries. In contrast, the agro-processing industry represents a proportionately larger market. Even so, two projects – the Kabuye Sugar Works factory (Madhvani Group) and the Bralirwa brewery (Heineken) – represent over 90 per cent of projected flows in agro-processing. This concentration further underscores the limited size, both in terms of number of projects and amounts, of FDI flows in Rwanda.

Figure I.8. Sectoral distribution of RIEPA-registered FDI projects, 2000-2005
(Percentage of total)



Source: RIEPA.

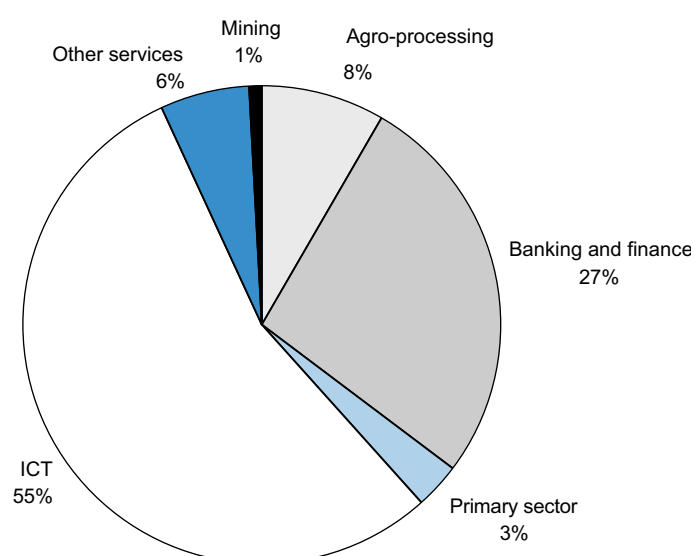
Foreign investment projects in the ICT sector account for 22 per cent of the total, and those in “other services” represent another 22 per cent. Once again, a few projects, including those by Terracom in ICT and Shell in oil distribution, account for a large share of these investments. In contrast, projects in manufacturing, which represent 9 per cent of the total, are less concentrated and more evenly of a small-size nature. RIEPA registered a total of 20 projects in manufacturing, none of which exceeded \$3 million.

¹³ Including operational and non-operational projects.

¹⁴ Including trading, oil distribution and land surveying.

The sectoral distribution of FDI resulting from the privatization programme is also significantly different from that of RIEPA-registered projects. Three “large” asset sales¹⁵ in banking and telecommunications imply that these two sectors account for 27 per cent and 55 per cent of foreign investments through the privatization programme, which themselves account for over a third of total FDI flows in the past few years (figure I.9).

Figure I.9. Sectoral distribution of foreign purchases of privatized companies, 1997-2005
(Percentage of total)



Source: Secrétariat de la Privatisation.

3. Types of FDI and countries of origin

The privatization programme has represented a significant channel of entry for FDI over the past decade, not so much as a result of a large number of operations but because of a few large transactions relative to total investment (section A.1). About 36 per cent of FDI flows, equivalent to \$17 million, resulted from the privatization programme between the first transaction in 1997 and the end of 2004.¹⁶ This share increases to around 80 per cent if one counts the amounts invested by the new owners of privatized companies to restructure or rehabilitate assets.

As indicated earlier, most foreign investments are small (box I.3). Projects registered by RIEPA between 2000 and March 2005 (whether operational or not) averaged \$2.5 million over the whole business plan, with 39 projects out of 58 below \$1 million. A good number of projects are also undertaken by individual investors, not by companies established elsewhere in the region or beyond. Similarly, a very small number of large multinationals have a presence in Rwanda, whether for production or simply for trading.¹⁷

¹⁵ BACAR, BCR and Rwandatel.

¹⁶ This excludes the sale of Rwandatel in mid-2005 for \$20 million, with cash payments spread over 10 years.

¹⁷ Large multinationals present in Rwanda include: Heineken, MTN and Total. Fortis Group (Belgolaise) and Shell recently withdrew. None of them use Rwanda as a production centre beyond the country itself.

The origins of FDI flows are also concentrated in a relatively small number of source countries, where investors are more familiar with Rwanda. Europe (mostly Belgium, France and the United Kingdom), neighbouring African countries and India together account for 64 per cent of RIEPA-registered FDI flows, with the United States, Canada and a very small number of other countries, mostly from the Middle East, accounting for the rest (figure I.10). All investments from African countries originated from Kenya, South Africa or Uganda. Similarly, investors who purchased shares in privatized companies were mostly from the United States, the United Kingdom, Belgium or neighbouring African countries.

Box I.3. FDI by small and medium-sized enterprises

Rwanda's small market size and high operating costs currently prevent it from attracting most large TNCs in search of new markets or internationally competitive centres of production. Individuals, families and small- and medium-sized enterprises (SMEs) are also active foreign investors, however, and they are more likely to be interested in investing to serve the local or subregional market and to identify niche opportunities. They are also more likely to be attracted by some of Rwanda's main assets, including a safe and pleasant environment and political stability. Their smaller size, in turn, is a good match for Rwanda's economy and they are in a position to make substantial contributions to development, including through the use of adapted technologies, transfers of skills and competences and the densification of the domestic industrial and services sectors. Two recent projects by small foreign investors illustrate the benefits of this type of investments:

Rwacom was set up by an investor of Indian origin who had lived in Rwanda before 1994. After fleeing and having much of his assets destroyed during the genocide, he returned to Rwanda to reclaim his property and start anew. He set up an import and export trading house as well as a small factory to manufacture plastic jerrycans, which are extensively used in the countryside to transport water. Raw materials are entirely imported and production costs are higher than in neighbouring Uganda or Kenya, but the large bulk, low weight and low value of jerrycans make it competitive to produce them locally due to high transport costs. Although the market is minute for a TNC, it is large enough to justify an investment by a small investor, who is also in a better position to identify the niche and supply a product that is adapted to local needs.

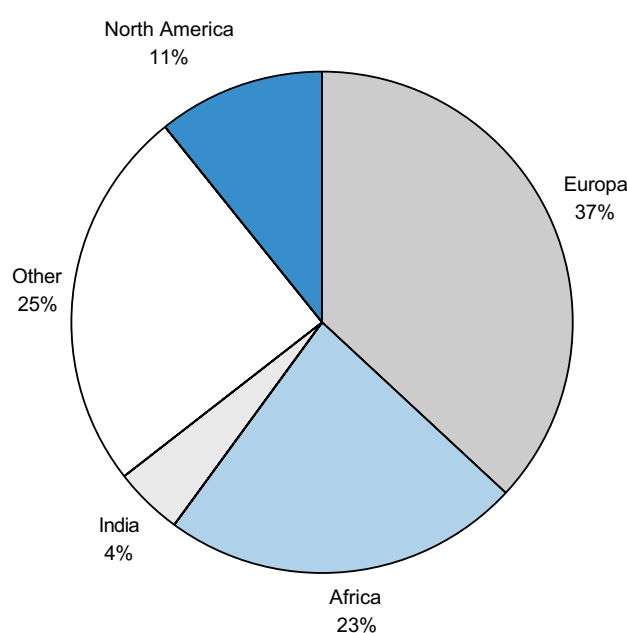
Khana Khazāna is an Indian restaurant that was recently established in Kigali by a family-owned group based in Kenya and Uganda. The family owns restaurants in Kampala and plans to expand to South Africa. Khana Khazāna caters for the growing demand for quality food services in Kigali and has started to fill the supply gap. Although the restaurant is managed by the family and head cooks are Indians, all other posts are filled by Rwandans who have received a couple of months of training before the restaurant started operating. Similarly, while spices and other key ingredients are imported from India, the restaurant has established a stable relationship with local suppliers of food products, providing income to people in rural areas.

Source: investor interviews.

The combination of a landlocked, small and underdeveloped market, high operating costs and image problems means that opportunities for foreign investors are concentrated mostly on supplying goods and services on a small scale and in niches. As a result, Rwanda is in general not in a position, for the time being, to attract large TNCs. The underdeveloped nature of the industrial and services sectors and the

natural degree of protection in the domestic market resulting from high transport costs, however, imply that niche opportunities are numerous, albeit too small to attract large investors. As illustrated by trends over the past few years and by the experience of other countries emerging from a period of conflict, small investors from the region or with previous knowledge of Rwanda are more likely to identify and value these opportunities. They are more likely as well to be aware of improving investment, social and political conditions, to move beyond Rwanda's image problem, and they can make significant contributions to development.

Figure I.10. Country distribution of RIEPA-registered FDI projects, 2000-2005
(Percentage of total)



Source: RIEPA.

C. Assessment

Rwanda has made considerable strides politically, socially and economically since the genocide of 1994. The Government has succeeded in restoring peace and stability and has firmly established the process of economic reconstruction. The consolidation and long term sustainability of peace and stability, however, require further political and social efforts, particularly through the justice and reconciliation work undertaken under the Gacaca court procedures. Sustained peace and stability are also likely to hinge upon rapid economic development, job creation in the formal sector and poverty reduction.

The vast majority of the population continues to work in agriculture or as subsistence farmers because employment opportunities in the formal sector are scarce and much of the population lacks formal skills. Sustainable development, poverty reduction and employment creation will require a profound transformation of the economy to make it more urbanized and based on the production of services and industrial goods. This transformation will require significant investment by the private sector, which should itself be supported by public sector investment in infrastructure and human capital.

Rwanda nevertheless faces a severe shortage of financing capacity and human capital. While ODA and external borrowing can fill some of the financing gap and foster domestic investment (particularly

public sector investment), FDI is in a unique position to complement national private investment, widen the economic base, underpin a dynamic private sector, and contribute to building human capital through the transfer of skills, know-how and basic technologies, all of which are key goals of the Vision 2020 development strategy.

Rwanda's state of development, quality of infrastructure, high operating costs and small market size make it illusory to attract FDI from major TNCs on a large scale at the moment. The "image gap" generated by the genocide and the recent instability in the Great Lakes region also continue to act as a major brake to FDI, and further efforts should be made to match perceptions abroad with the current political and social reality of Rwanda. In contrast to large TNCs, small foreign investors from the region and a few other countries are much more likely to be attracted by Rwanda's market and investment conditions, and be more aware of the positive changes of the past decade. They are also likely to benefit the economy as a whole, as they constitute a good match for the country's development needs. Aside from bringing capital, small foreign investors are in a position to bring entrepreneurship, know-how and technologies that are adapted to Rwanda's level of development and that can spread to the economy as a whole. Far from crowding out local investors, small foreign investors could also contribute to a densification of the industrial and services sectors, which would benefit national investors and would allow, at a later stage, to attract larger foreign investors requiring a denser and higher quality network of domestic suppliers.

FDI trends over the past few years indicate that Rwanda is slowly starting to generate interest among foreign investors. Investment inflows remain very small, however, and far below what is needed for FDI to have a major impact on job creation, output, productivity and the transformation of the economy. Too large a proportion of FDI flows over the past few years has also depended on the privatization programme, which will not be sustained in the medium term, and on typical investments in post-conflict countries (mobile telecommunications). The challenge for Rwanda in the years to come is to firmly entrench peace and stability, and to attract foreign investors with a long-term vision. Attracting the type of foreign investors described above calls for a well-targeted FDI strategy integrated in the Vision 2020 development framework. This is the subject of chapters II and III of this Review.

II. THE INVESTMENT FRAMEWORK

A. Introduction

Rwanda has embarked upon an ambitious programme to modernize its legislative and regulatory framework for investment, with the aim of fostering a “modern, competitive private sector (...) geared towards capital formation”.¹⁸ Much of the body of investment-related laws inherited after the 1994 genocide was either outdated or not adapted to a market economy. The Government is committed to promoting growth and poverty reduction through the development of a market-driven private sector and it has reformed or put in place a number of key laws and regulations in the past decade. Much still remains to be done to establish a modern and fully operational legal and regulatory framework for investment, but the Government is strongly committed to the modernization efforts and it established a business law reform commission in September 2005. Overall, the progress realized so far is impressive given the situation inherited in 1994.

B. Constitutional set-up

The Arusha Peace Agreement of 1993 served as the constitutional basis for a government of national unity from July 1994 until a new Constitution was adopted in June 2003. The adoption of the new Constitution by referendum paved the way for the first post-genocide legislative and presidential elections, and represented a further step towards entrenching peace and stability. The Constitution provides a framework for the fundamental individual rights expected in a modern democracy and establishes a multi-party system for the first time in Rwanda since independence, with the exception of a doomed attempt to introduce democracy with the 1991 Constitution.

The Constitution, aside from the usual separation of executive, judiciary and legislative powers, puts in place a number of mechanisms that seek to deal with the consequences of the 1994 genocide and ensure that the peace and stability gained over the past decade are reinforced and sustained. These provisions include:

- Political parties may not identify themselves upon the base of race, ethnic background, region, religion, gender or any other element that can serve as a basis for discrimination;
- Judges, prosecutors and members of the armed forces and the police may not belong to political parties;
- The Constitution establishes Gacaca courts responsible for the trial and judgment of a number of crimes of genocide committed between 1 October 1990 and 31 December 2004 (box II.1).

The Constitution establishes a bi-cameral presidential system. Members of the Chamber of Deputies are elected by direct universal suffrage for five-year terms, following a system of proportional representation. The Chamber has sole responsibility over the passing of the finance bill. Members of the Senate are elected or designated for eight-year terms. The Chamber of Deputies and Senate must both vote on Bills in order to enact them into law.

¹⁸ Ministry of Finance and Economic Planning, Vision 2020.

Strong powers are vested in the presidency, although checks and balances have been instituted in the Constitution. The President is elected by direct universal suffrage with a simple majority of votes cast, for a seven-year term which can only be renewed once. The President is commander in chief of the defence forces and is head of the executive branch of Government. He/she nominates or fires the Prime Minister and has the power to dissolve the Chamber of Deputies, but this may be done only once per presidential term.

Box II.1. Gacaca courts: justice and reconciliation

The active involvement of a large number of people in crimes of genocide in 1994 left Rwanda with a tremendous challenge: providing justice for the victims and avoiding impunity, while at the same time promoting reconciliation. More than 100 000 people were imprisoned in the immediate aftermath of the genocide, and the judiciary system was all but destroyed. By November 1994, the judiciary system consisted of 244 judges, 12 prosecutors and 137 support staff. It was by no means in a position to render general justice, let alone cope with the trial of people indicted for crimes of genocide. Despite efforts to train additional judges and prosecutors, it became obvious that the traditional judiciary system could never cope with the backlog of genocide cases. It was also determined that it was not best positioned to ensure both justice and reconciliation. Gacaca courts were thus created under Law 40/2000, confirmed in the 2003 Constitution and reformed under Law 16/2004.

Gacaca courts and procedures aim to speed up the judicial process, establish participatory justice and promote reconciliation. They are competent to judge crimes of genocide of categories 2 and 3, i.e. those that did not involve planning, incitation, supervision, rape, excessive cruelty or involving people in positions of authority (category 1), which remain the competence of the national jurisdiction. The courts have been established at the provincial and local level, and involve non-professional judges. The proceedings are public and seek to establish the truth about events so as to facilitate reconciliation and the healing process. The Government is also keen to ensure that crimes of genocide do not remain unpunished, as it considers justice a key element to reconciliation.

The Gacaca court system has already brought about significant results, even though a large number of people remain imprisoned. Around 20 000 people were released from jail in August 2005 following guilty pleading procedures that allow a sentence reduction. Prior to their release, they had to go through Ingando (“solidarity camps”) for one month, where they were taught about the law, good citizenship and peaceful co-existence. The successful and peaceful reintegration of prisoners into civil society will also require that they rapidly find a means of subsistence, however. In that respect, the economic transformation and job creation process will be crucial to entrench peace and stability.

While the Gacaca court system has significantly eased the load on the traditional system and provided a more suitable tool for participatory justice, healing and reconciliation, major work remains to be done to further rebuild the traditional judiciary system. A significant number of judges, prosecutors and lawyers still need to be trained, including in technical and business-related fields. ODA assistance would be particularly useful in that area, as is the work of non-governmental organizations (NGOs) such as *Avocats Sans Frontières*.

Sources: Service National des Juridictions Gacaca and Avocats Sans Frontières.

Some elements in the Constitution are of particular relevance to investors:

- Every person has the right to private property;
- Expropriation of property rights is allowed only where public interest requires it and following fair and prior compensation;
- Any foreigner lawfully present in Rwanda enjoys the same rights as citizens, except for rights specifically restricted to Rwandans as determined by law;
- International treaties and agreements have seniority over national laws (with the exception of the Constitution) as long as all signatory parties are in compliance with them.

Much remains to be done to ensure the full implementation of the principles spelled out in the Constitution, including through the adoption of a number of new laws, stronger institutions and the emergence of a stronger civil society. Its adoption in 2003 nevertheless represents a major step towards the consolidation of the peace and stability that have been progressively rebuilt since 1994.

C. Entry, treatment and protection of FDI

I. Entry and establishment of FDI

Rwanda has put in place one of Africa's most open FDI regime as it does not place restrictions on FDI entry and establishment. All foreign investments are allowed without screening or restriction of amount or sector, and foreign investors are granted national treatment for most intents and purposes.¹⁹ A positive element *per se*, this high degree of openness makes it all the more important that other regulations (relating to public health, consumer interests, environmental protection, etc.) be properly established and enforced (section E).

Investors (local or foreign) who choose to register with the Rwanda Investment and Export Promotion Agency (RIEPA), which was created under Law 14/98,²⁰ can apply for additional benefits. An Investment and Export Promotion and Facilitation law was adopted in late 2005 to amend Law 14/98 and consolidate all fiscal incentives into the income tax code, which was revised at the end of 2005 as well. The spirit and key elements of Law 14/98 remained unchanged, however (table II.1).

The benefits provided to holders of RIEPA certificates consist mostly in access to facilitation services, fiscal incentives (section D.1), the entitlement to three work and residence permits for foreign citizens (section D.4), investment protection (section C.2) and guarantees for the repatriation of funds (section D.3). The Investment and Export Promotion and Facilitation law of 2005 defines a number of priority sectors²¹ and regional headquarters operations, which did not exist under Law 14/98, and which are eligible to additional tax incentives (section D.1). Although all the fiscal incentives are now defined in the income tax code, RIEPA certificates remain the gateway to these incentives, and it plays an administrative role for some of them.

¹⁹ The 2005 Investment and Export Promotion and Facilitation law explicitly states that "foreign investors may invest and participate in the operation of any business in Rwanda, and they shall enjoy incentives and facilities no less favourable than those enjoyed by local investors."

²⁰ Law 14/98 initially established the Rwanda Investment Promotion Agency (RIPA). RIPA's mandate was widened to export promotion in 2004 and the agency renamed Rwanda Investment and Export Promotion Agency (RIEPA).

²¹ ICT, tourism, energy, agriculture and agribusiness, industry, re-export, mines, research and development, education and human resources development and infrastructure.

Incentives to holders of RIEPA certificates apply equally to national and foreign²² investors, but foreigners are required to invest a minimum of \$250 000 to be eligible for certificates, while the threshold for nationals is \$100 000.²³ The minimum capital requirement is interpreted flexibly by RIEPA, which considers all capital injections over the period of the business plan. The other main requirements for eligibility are: (1) providing information on the capital structure and ownership of the company; (2) maintaining proper accounts and financial statements; (3) registering and filing returns with the Rwanda Revenue Authority (RRA); and (4) providing annual reports. In turn, RIEPA is required by law to consider the request for and deliver, if eligible, a certificate within 10 business days.

Table II.1. RIEPA certificates, eligibility conditions and benefits

	Previous regime	New regime
Eligibility conditions and obligations		
Minimum capital requirement, nationals	\$50 000	\$100 000
Minimum capital requirement, foreigners	\$100 000	\$250 000
Capital and shareholder structure	yes	yes
Filing and reporting requirements	yes	yes
Detailed business plan (5-year projection)	yes	yes
Benefits to holders		
Access to facilitation services	yes	yes
Condition for some fiscal incentives	yes	yes
Fiscal incentives in investment law	yes	no
Work and residence permits, number and (minimum investment)	3 (\$100 000 or \$50 000)	3 (\$100 000)
Facilitated recourse to int'l arbitration	yes	yes
International transfer of funds guarantees	yes	yes
Guaranteed tax-free repatriation of expropriated assets	yes	yes

Sources: Law 14/98 and 2005 Investment and Export Promotion and Facilitation law.

RIEPA, which became operational in 2000, was established from the start as a one-stop centre providing support services for incorporation, licensing, Customs clearance, access to land and immigration. It has firmly established itself in Rwanda's institutional landscape and currently employs around 30 professionals. The mandate of the agency is wide-ranging and includes:

- Investment and export promotion;
- Investment and export facilitation;
- After-care services;
- Policy advocacy on investment and export issues.

²² Citizens of COMESA countries or companies incorporated in Rwanda and majority-owned by COMESA nationals are considered "national investors".

²³ The minimum capital requirements were revised upward in 2005 from \$100 000 and \$50 000, respectively, under Law 14/98. This rule is the only exception to national treatment provided for in the Investment and Export Promotion and Facilitation law.

The legal requirements that make RIEPA certificates the gateway to a number of fiscal incentives and other benefits is not optimal. As indicated below, making the fiscal regime attractive in general, with outcome-determined incentives, would be more appropriate to serve the country's interests.

Discriminating against small investors through minimum capital requirements is not in Rwanda's interest. Small investors should not be granted less favourable conditions than larger investors, particularly in an economy like Rwanda, where they are likely to play a key role. The initial size of an investment is not necessarily a good indicator of the potential benefits to the economy in the medium term. This is particularly the case for investments in the services sector, which typically require little upfront investments in financial capital but have a high human capital intensity.

The following approach to RIEPA certificates is thus recommended:

- Lift the minimum capital requirement as an eligibility condition;
- Preserve a capital requirement to benefit from automatic access to 3 work permits;
- Lift the certificates' role as a condition to obtain fiscal incentives;
- Use general eligibility conditions for certificates to promote an "induction" programme.

The "induction" programme would effectively seek to promote responsible corporate behaviour by RIEPA certificate holders. Registration with RIEPA would provide access to general benefits, but would also require that the company's key officers complete an induction programme on Rwanda's key business laws, corporate responsibilities (employment practices, tax compliance, observance of health and safety standards, environmental protection) and business ethics. The certificate could lapse if the investor becomes or remains non-compliant for tax purposes. RIEPA certificates and eligibility conditions would thus not discriminate on a size basis, but would promote good business practices and compliance with Rwanda's laws.

2. Treatment and protection of FDI

Article 42 of the Constitution specifies that "every foreigner legally residing in the Republic of Rwanda shall enjoy all rights save those reserved for nationals as determined under this Constitution and other laws." In addition, the Investment and Export Promotion and Facilitation law of 2005 stipulates that foreign investors benefit from incentives and facilitation on terms no less favourable than those granted to national investors.

The Constitution also grants protection over private property rights, which can be expropriated only for reasons of public interest and following fair and prior compensation. In addition, holders of RIEPA certificates are entitled to fair compensation in a convertible currency in case of expropriation. They also benefit from the guarantee that the compensation will be free of any tax or duty and freely transferable overseas.

RIEPA certificates also facilitate recourse to international arbitration in case of an investor-State dispute. Pending efforts to reach a negotiated settlement (but *not* the exhaustion of local judicial remedies), registered investors may request international arbitration under either an applicable bilateral treaty or a multilateral agreement – including the International Centre for Settlement of Investment Disputes (ICSID).²⁴ In general, investors seeking recourse to ICSID arbitration must obtain the agreement of the State. In contrast, consent to international arbitration (including with ICSID) is explicit for holders of RIEPA certificates, and does not require the exhaustion of local judicial procedures.²⁵ RIEPA certificates also offer the option to predefine the mode of arbitration to use in case of dispute, in which case both the State and the investor are bound by that mechanism.

As of mid-2006, no international dispute involving the State of Rwanda and a foreign investor had been brought to ICSID for arbitration. Aside from its membership of ICSID, Rwanda has signed bilateral investment treaties (BITs) with Belgium-Luxembourg, Germany and Switzerland, and these were ratified in the 1960s and 1980s. The provisions in these agreements are standard in that they provide for national treatment, guarantee transfer rights and provide for automatic access to international arbitration if local court procedures have been ineffective for a certain period of time. Overall, Rwanda's network of BITs is extremely limited. Additional BITs could reassure foreign investors unfamiliar with Rwanda and provide extra certainty in what is a “frontier territory” for most people (chapter III). “Home country” measures, including political risk insurance could also be used to reduce risk and promote FDI. At the moment, political cover is available through the Multilateral Investment Guarantee Agency (MIGA), but no project has so far been guaranteed by MIGA.²⁶

D. General measures for regulating business

I. Taxation

Rwanda has made significant efforts to modernize its tax system in recent years, even though further efforts should be made to improve the structure of taxes and their administration. The Rwanda Revenue Authority was established in 1997 under Law 15/97 as an autonomous public body, and it is allowed to retain 6 per cent of total revenue to finance its operations. The RRA was reorganized in 2004 around three departments (large taxpayers, internal revenue and Customs) in order to build synergies in tax management and in services to taxpayers. The large taxpayers department deals with a little under 300 companies and institutions that generate close to 80 per cent of corporate income tax and VAT. The income tax department deals with around 4 000 small and medium-sized enterprises (SMEs) and personal income taxes. Although it is too early to assess the impact of this structural reorganization on the administration of the tax system, the revenue to GDP ratio rose from 9.9 per cent in 1999 to 13.9 per cent in 2004.

a. VAT

Value-added tax (VAT) was introduced in 2001 by Law 06/2001 to replace turnover tax. The structure of the VAT system is modern and similar to that of most other countries, and the RRA has succeeded in administering it well within a short period of time. VAT applies to goods and services, whether produced

²⁴ Rwanda has been a member of ICSID since November 1979.

²⁵ All efforts must be undertaken to reach an amicable settlement prior to calling for international arbitration, however.

²⁶ MIGA is part of the World Bank Group and offers cover for four types of political risks: (1) transfer restrictions; (2) expropriation; (3) war and civil disturbance; and (4) breach of contract.

locally or imported. Two rates were set in 2001: most goods and services are taxed at 15 per cent and exports are taxed at 0 per cent. A number of goods and services are also exempt.²⁷ The base rate was increased to 18 per cent in 2002, which helped raise VAT collection from 30.5 per cent of total revenue in 2001 to 34.8 per cent in 2004 (table II.2).

Suppliers of taxable goods or services with annual turnover in excess of Rwf15 million (\$26 000) must register, while other suppliers may do so on a voluntary basis. Investors seeking RIEPA incentives are also required to register for VAT purposes. Returns must be filed monthly on an accruals basis. Refunds can be claimed whenever input tax exceeds output tax without condition. The law stipulates that the RRA must refund excess payments within 30 days, or up to a maximum of 3 months if the claim must be investigated. Although the RRA frequently investigates claims, refunds appear to be effected efficiently and expeditiously. The RRA also faces a monthly penalty of 1.5 per cent in case of delays, which is the same penalty that investors face in case of late payments.

No major changes are necessary to the VAT system or its administration. The authorities should nevertheless consider allowing companies to deduct VAT paid on imported services (“reverse charges”) as input VAT. At the moment, deductions are allowed only when services are “deemed not to be available in the local market”, i.e. when there is no single firm producing similar services locally. This definition is far too restrictive, as services may not be available in sufficient quantity and at the appropriate level of quality. Optimally, all VAT charges paid on services imports should qualify for deduction as input VAT when the service is used for business purposes.

Table II.2. RRA, structure of revenue collection
(Percentage of total revenue)

	2000	2001	2002	2003	2004
Direct taxes	28.0	30.4	32.2	30.7	28.3
Corporate taxes	15.4	18.2	18.1	13.7	11.5
Personal taxes & others	12.6	12.2	14.1	17.0	16.8
Taxes on goods and services	54.1	51.8	50.4	50.1	52.2
VAT ¹	21.2	30.5	31.9	33.3	34.8
Excise & others	32.9	21.3	18.4	16.8	17.4
Taxes on international trade	17.9	17.8	17.4	19.2	19.5

¹ Turnover tax prior to 2001.

Source: Rwanda Revenue Authority.

b. Corporate and personal income tax

The corporate and personal income tax code was overhauled in 1997 under Law 8/97 and was further reformed at the end of 2005 (Law 16/2005). Although the reforms have improved the structure, administration and efficiency of the tax system, the code still suffers from a number of weaknesses.

²⁷ These goods include: health care, educational services, transport services, books, agricultural inputs, ICT goods and certain goods imported under RIEPA certification.

Key among these are: (1) a lack of clarity and some inconsistencies in different language versions of the laws;²⁸ (2) a complex and administratively burdensome structure of incentives; and (3) an insufficiently clear vision as to how fiscal incentives can help achieve national development goals and how they should be structured. The income tax code of 2005 will apply from fiscal year 2006. It introduces a number of changes from Law 8/97, without generating a fundamental overhaul. The main characteristics of the income tax code of 2005, compared with Law 8/97 are as follows (table II.3):

- The corporate income tax rate has been lowered to 30 per cent from 35 per cent previously.
- The rules for deductions for depreciation of capital assets have been simplified, and the rates modified. All assets are depreciated on a straight line basis, and the rates closely track the actual useful life of the assets. While rates have been increased in a number of cases, plants and machinery are subject to slower depreciation under the new income tax code.
- Loss carry-forward is bounded to five years, unchanged from Law 8/97.
- The withholding tax rate on dividends, management fees and interest income has been harmonized at 15 per cent. Dividend payments to non-residents were not subject to a withholding tax previously, while agency fees and interest income were taxed at 20 per cent.
- The 2005 code introduces unilateral tax credits on foreign sourced income.
- The 2005 code introduces provisions for transfer pricing, although their operationalization remain to be defined by rules of implementation.

One of the purposes of Law 16/2005 and the Investment and Export Promotion and Facilitation law of 2005 was to consolidate all fiscal incentives in the income tax code. While this has indeed been achieved, most incentives remain conditional upon obtaining a RIEPA certificate. Given the minimum capital requirement to be eligible for such certificates (section C.1), this implies that the incentives will not be available to small investors. The RIEPA-linked incentives are:

- The zero-rating of VAT on imported capital goods and raw materials that are subject to zero-rated tariffs. This incentive already existed under Law 8/97.
- A flat 5 per cent tax in lieu of all other duties (tariffs, excise and VAT) on imported capital goods and raw materials that are not subject to zero-rated tariffs. The exemptions require RIEPA and RRA authorization for each transaction.
- An accelerated rate of depreciation of 40 per cent in the first year, on the additional condition that the investment be at least Rwf30 million (\$54 000) and that the asset be held for a minimum of 4 years. The accelerated rate of depreciation is increased to 50 per cent in the first year for investments located outside the Kigali area or in one of the 10 priority sectors defined by the Investment and Export Promotion and Facilitation law of 2005 (section C.1).
- A special regime has been introduced for international headquarters operations providing a 0 per cent corporate income tax rate and exemption from dividend withholding tax. This regime is conditional upon a minimum capital investment of \$2 million and local expenses of \$1 million per year.

²⁸ Kinyarwanda, English and French are the official languages. The issue of consistency between the three language versions of the laws, which are all equally valid and deemed equivalent in Court, is a general issue and not restricted to tax laws. It is particularly important in technical areas, where translations are more difficult and where terms may not exist in Kinyarwanda.

Table II.3. Corporate taxation, 1997 and 2005 laws
(Percentage, unless otherwise specified)

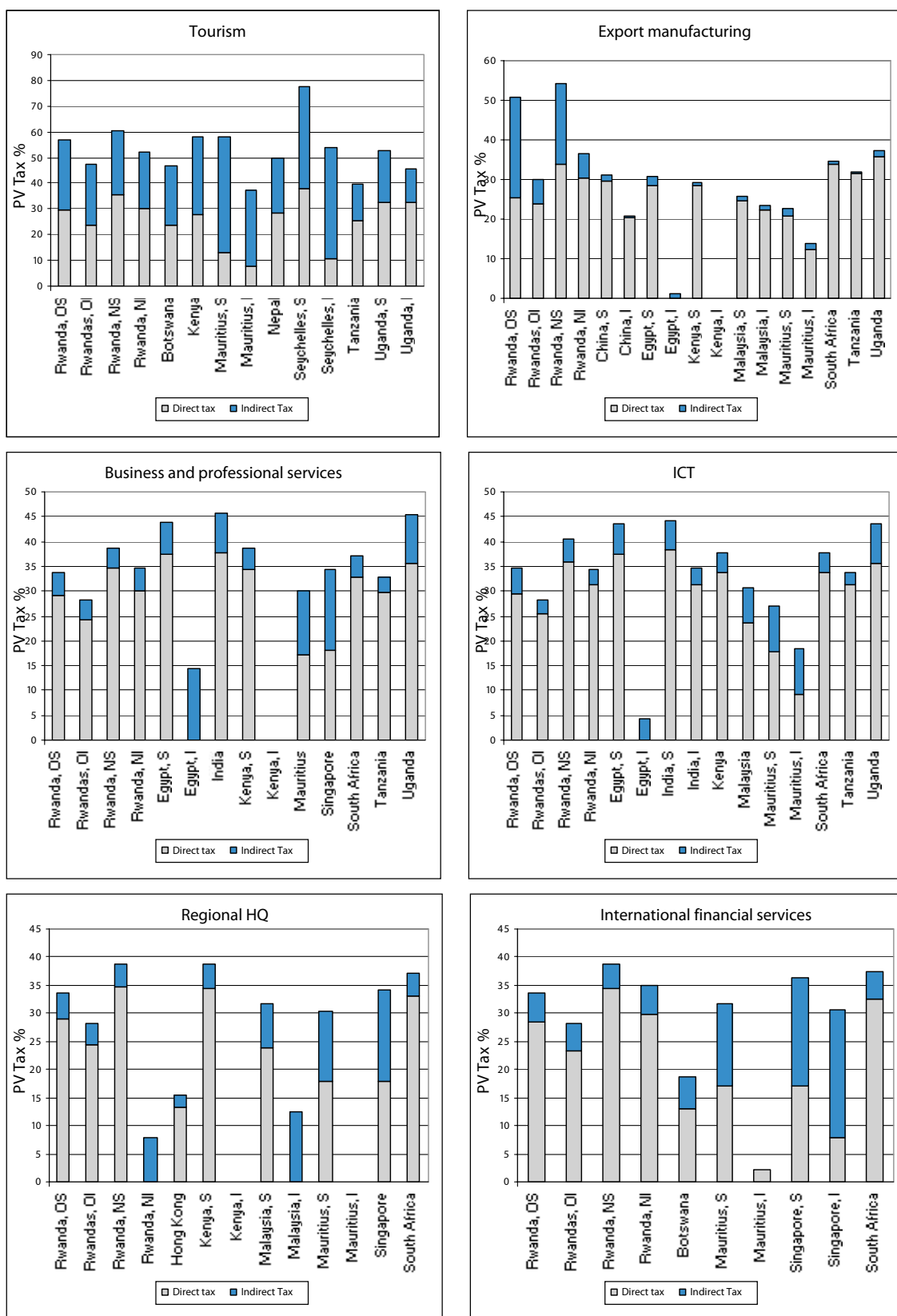
	1997 Code	2005 Code
Corporate income tax rate	35%	30%
Withholding rate dividends to non-residents	0%	15%
Withholding rate on agency fees and interest	20%	15%
VAT rate		
Standard	18%	18%
Exports	0%	0%
Loss carry-forward (years)	5	5
Depreciation rates (straight line)		
Buildings	4%	5%
Plants and machinery	15%	5%
Computers	33.3%	50%
Office equipment	20%	25%
Goods vehicles	25%	25%
Foreign-sourced income	Tax credit under DTT only	Unilateral tax credit
RIEPA certificates necessary for incentives	yes	yes
Incentives		
5 percent flat fee on imports	yes	yes
Investment allowance (30 percent)	yes	no
Accelerated depreciation	no	yes
Employment-based tax rate reduction	no	yes
Export-based tax rate reduction	no	yes

Source: Law 8/97 and Law 16/2005.

In addition to these incentives that require RIEPA certification, the 2005 income tax code introduces two additional incentives based on outcomes:

- A reduction in the corporate income tax rate of 2, 5 or 6 per cent for companies employing a large number of Rwandans (from 200 to more than 900);
- A reduction in the corporate income tax rate of 2 or 5 per cent for companies exporting \$3-5 million a year or more than \$5 million a year, respectively;

Figure II.1. Comparative taxation of investment



Source: UNCTAD.

The income tax code includes a number of provisions that impact companies' cash flow. Businesses file income tax returns annually but are required to make anticipatory payments on a quarterly basis, with the amount due equal to one quarter of the total income tax paid in the previous year. Although these anticipatory payments are deducted from the end-year tax due, excess payments are not reimbursed,²⁹ but instead credited towards future obligations (including future anticipatory payments). Similarly, winners of public tenders face a deduction of 3 per cent of the value of invoice as an anticipatory payment on future income tax. Even though these measures do not affect the total amount of income tax payable, they do negatively affect company cash flow. This may constitute a barrier to investment and business expansion, particularly in a situation where most companies face a high cost of, and difficult access to, finance.

Figure II.1 summarizes the overall tax burden as measured by the present value of tax (direct and indirect) as a percentage of the project's pre-tax cash flow (annex). Data is provided for the regime that prevailed until 2005, under the standard and incentives cases (OS and OI), and for the new income tax law, under the standard and incentives cases (NS, NI). Data for comparator countries is either under a standard regime (S) or under an incentive regime (I). Comparator countries are selected either because they are direct competitors for Rwanda, or to illustrate the fiscal regime put in place by countries that have demonstrated success in developing a certain sector.

In general, corporate taxation in Rwanda does not appear to place an excessive burden on investors or to be uncompetitive relative to a number of comparator countries. Rwanda's regime can be qualified as "average", but it is not among the countries with the lowest tax burden.³⁰ This statement holds for most sectors with the notable exception of Rwanda's export manufacturing sector, where the burden of indirect taxes is high, unlike most other countries with elaborate duty drawback schemes for exporters.

Although the Law 16/2005 lowers the corporate income tax rate from 35 to 30 per cent, the modelling shows that the tax burden on *foreign* investors will in general *increase* compared with the level under Law 8/97. This is essentially the result of the introduction of a 15 per cent withholding tax on dividends paid to non-residents. The tax burden on domestic investors, in contrast, will fall under the new rules.

This modelling indicates that the fiscal burden is not a major impediment to investment. Yet, Rwanda's "average" position also means that the tax regime is not a pull factor for investment. A number of improvements and modifications could be introduced to make the fiscal regime more attractive and competitive, as part of the strategy to turn Rwanda into a "centre of excellence in soft infrastructure and governance" (see below). The reforms would:

Make Rwanda's general fiscal regime the most competitive and well-administered in the region

A number of incremental improvements and modifications could be introduced over the next few years in order to make Rwanda's tax regime a model of excellence in administration, efficiency and fairness, and the most competitive in the region. The recent reduction in the corporate income tax rate is a step in the right direction, as is the decision to provide unilateral tax credits on foreign sourced income. Additional measures to make the *general* regime more competitive could be adopted:

²⁹ Except if the company is wound down.

³⁰ With the exception of regional headquarter operations, for which the 2005 law establishes a particularly favourable tax regime, subject to certain conditions.

- Lower the headline corporate income tax rate to 25 per cent in the near future and bring the dividend withholding tax rate to 10 per cent;
- Provide for faster rates of depreciation on durable assets and allow unlimited loss carry-forward in lieu of the current five years;
- Set up a comprehensive duty drawback scheme for exporters;
- Further improve capacity at the RRA, provide more clarity on tax regulations and ensure full consistency between the three language versions of the fiscal laws and regulations;
- Draw up clear guidelines and regulations for transfer pricing;
- Minimize the impact of taxation on companies' cash flow, including through removing the anticipatory payments on corporate income tax and the 3 per cent tax on the value of invoice for winners of public tenders.

Streamline the administration of incentives

Incentives provided by law should be easy to administer and widely and readily available to investors. RIEPA certificates should not be required to access incentives and it serves no real purpose to restrict access to tax incentives to large investments and discriminate against small investors, who are likely to play a key role in Rwanda's development. RIEPA could dispense altogether with the minimum capital requirements for certificates.

Make fiscal incentives outcome-based and targeted to development goals

Incentives should be conditional upon outcomes and available to all who reach the desired outcome, regardless of other conditions (size, time of establishment, etc.). These could focus on employment creation and export promotion (as is already the case), but could also target the transfer of knowledge and skills. The Government could consider:

- Supplementary deductions from the income tax base for personnel training expenses;
- Targeted incentives to attract foreign skills and entrepreneurship (section D.4).

Minimize the impact of taxation on companies' cash flow

This would call for removing measures such as anticipatory payments on corporate income tax and the 3 per cent tax on the value of invoice for winners of public tenders.

c. Export processing zones

Although an export processing zone (EPZ) scheme was established under Law 14/98, no zone has been set up so far. The 2005 Income Tax and Investment and Export Promotion and Facilitation laws have reformulated and enhanced the incentives provided under a new EPZ scheme. RIEPA has now identified an area around Kigali to set up an EPZ, and it estimates the development cost at around \$70 million, of which the public sector would cover around \$45 million. The targeted uses and sectors are wide, including logistics, warehousing, manufacturing and services.

Under the new scheme, RIEPA is responsible for the supervision of EPZs, which can be privately or publicly established. Single-enterprise zones are also allowed, and investments in industrial, commercial and

services activities are permitted on the condition that a minimum of 80 per cent of output be exported. Professional and financial services are allowed in the zones. The main incentives are:

- Exemption from import and excise duties and VAT on imported capital goods and production inputs;
- Exemption from withholding taxes on dividends and tax-free repatriation of profits;
- Zero per cent corporate income tax rate for an unlimited period of time.

These incentives provide a virtually tax-free operating environment for firms in EPZs. The Investment and Export Promotion and Facilitation law of 2005 stipulates that RIEPA will assess whether businesses proposing to establish in an EPZ will provide all or some of a number of benefits to Rwanda when granting licences to operate in EPZs.³¹ It is not clear that a traditional EPZ is the best instrument to attract the type of investments that the country would benefit most from. In particular, providing a tax-free environment for an unlimited period of time may be excessive, especially if the Government faces the cost of setting up some of the physical infrastructure to EPZs. It also runs the risk of attracting “non-sustainable” investors that choose investment locations mostly for incentives purposes and operate as enclaves with very limited linkages with the economy.

Better targeted incentives aimed at promoting the type of investments that Rwanda needs most may be a more efficient use of fiscal policy tools and scarce government resources. An alternative strategy, modelled around multi-facility industrial parks and free port logistics centres would be more appropriate for Rwanda (chapter III, section E). The experience of other countries, including Kenya,³² also shows the difficulty of generating linkages and transfers of technology with investments in EPZs that are driven in good part by generous fiscal incentives.

d. Customs duties and inspection

Rwanda has gradually reduced the level of protection granted to its domestic producers over the past decade, with the weighted average MFN duty rate falling to 10 per cent in 2003 from 25 per cent ten years earlier. It maintains a clear escalation in duty rates, with capital goods subject to an MFN tariff of 0 per cent, raw materials taxed at 5 per cent, intermediate goods at 15 per cent and final consumer goods at 30 per cent. Rwanda’s imminent entry into the East African Community (EAC) and its Customs union will require a harmonization towards lower MFN rates.³³ It will also make it more difficult for Rwanda to further reduce MFN tariffs in the future if it wishes to pursue the policy of the past decade, as this will have to be done in consultation with all EAC members.

The Customs authorities, which are part of the RRA, have achieved significant improvements in administration over the past few years, although key weaknesses and delays remain to be addressed. The RRA eliminated pre-shipment inspection requirements in June 2004 and started implementing UNCTAD’s ASYCUDA++ Customs management system, which should improve Customs clearance procedures. It

³¹ Including: (1) creation of high quality jobs; (2) transfers of technology and knowledge; (3) export diversification; and (4) linkages with the local economy.

³² Much of the FDI in Kenya’s EPZs has been in garments assembly, and driven by AGOA preferences and generous fiscal incentives. As the impact of AGOA preferences diminishes as a result of the integration of trade in textile and garments under WTO rules, the long-term sustainability of these investments has become questionable. A number of companies have been closing cut, make & trim operations in Kenya, leaving little behind little in terms of linkages and transfers of technology.

³³ Customs union MFN rates are 0 per cent for raw materials and capital goods, 10 per cent for intermediate goods, and 25 per cent for final consumer goods.

requires direct trader input of Customs declaration data, which can now be done through the internet, dial-up or dedicated connections or on computers at the Customs offices. The system also allows the RRA to implement a risk-based sorting of shipments along three main routes (red, yellow and green) that require different degrees of documentary or physical inspections.

The authorities indicate that the average time for Customs clearance was around two days under the previous system, and full implementation of ASYCUDA++ is likely to reduce it further. This would bring Rwanda to an excellent regional standard, but still lagging in relation to the best global performers. As a landlocked country, Rwanda also depends on the efficiency of Customs procedures in neighbouring countries, particularly Kenya and the United Republic of Tanzania, the two main points of entry for most goods.

The Customs department has also made efforts to facilitate export procedures in recent years. In particular, it allows shipment inspections on premises for exporters of perishable goods, which cannot be stored at Kigali Kayibanda International Airport due to inadequate cold storage facilities. The Government also abolished all remaining export duties in 1999.

The key weakness in imports and exports handlings resides not so much in the Customs system *per se* as in the physical handling of goods. All imports must transit through MaGeRwa (Magasins Généraux du Rwanda), a bonded warehouse owned jointly by the Government, the Banque Rwandaise du Développement and private companies. MaGeRwa charges a fee of 4 per cent of the value of the goods, 1 per cent as a fee for handling and warehousing services, and 3 per cent as a tax to the RRA.

MaGeRwa's fee is a supplemental tax on imports, and the poor state or insufficient capacity of its infrastructure is the main cause of delays in goods clearance. Efforts to streamline and expedite Customs procedures at the RRA will thus not be complete until similar reforms are undertaken at MaGeRwa leading to: (1) fast and efficient handling of goods; and (2) the elimination of the supplemental tax on imports to leave only a cost-based fee.

2. Foreign exchange arrangements

Rwanda adopted a market-determined exchange rate system in 1997 under Law 11/97. The law establishes the statutes of the central bank, the Banque Nationale du Rwanda (BNR), which has full supervisory and regulatory power over the foreign exchange market.³⁴ It also allows the President, upon recommendation of the BNR and the Government, to fix the exchange rate for a limited period of time, if economic and financial conditions warrant it.

Given the systematic shortage of foreign exchange among private sector players,³⁵ the BNR is the single most important actor on the market. Large inflows of foreign aid have provided the BNR with sufficient access to foreign exchange to fill the demand for hard currency and orchestrate a progressive depreciation of the Franc from Rwf393/\$1 on average in 2000 to Rwf554/\$1 in June 2006. The BNR allows maximum daily fluctuations of Rwf5 to the dollar over the previous closing rate.

³⁴ As per Law 11/97 and Law 28/90 on exchange controls.

³⁵ This is the consequence of the recurrent trade and current account deficit, as Rwanda typically imports three to four times as much as it exports annually.

Exchange rate regulations were revised in March 2003 and introduced the requirement that foreign direct investors register their operations with the BNR. This is a simple registration requirement aimed at improving data collection, as operations are not subject to approval by the BNR. The regulations also specify that registration gives the subsequent right to foreign investors to freely repatriate current income related to these investments, as well as any amount raised from disposal of assets. Transfer rights for debt servicing obligations are also specifically covered in the regulations.

Rwanda has accepted the provisions of IMF Article VIII that require the exchange rate to be free of restrictions on payments and transfers for current account transactions. Capital account transactions, in contrast, have not been liberalized significantly, with most operations remaining subject to BNR approval.³⁶ The other main regulations affecting foreign exchange transactions include:

- Importers, exporters and banks are allowed to engage in forward transactions to cover foreign exchange risks;
- Banks are free to open foreign exchange accounts for residents. Non-residents' accounts are allowed but require BNR approval;
- Exporters are required to report all transactions in excess of \$10 000 and must repatriate the proceeds within three months of the goods being physically shipped. Proceeds may be retained in a foreign exchange account with a local bank;
- Local banks are allowed to transfer overseas up to 70 per cent of the earnings of expatriate workers, net of income tax and contributions to social security;
- There are no restrictions on the transfer abroad of dividends, royalties, interest or income from professional services by non-residents.

Rwanda's foreign exchange system is well suited to its economic and financial conditions and favourable to foreign direct investors. The Government could nevertheless consider lifting progressively certain restrictions on capital account transactions so as to favour the emergence of an internationally-oriented banking system (chapter III).

3. Labour regulation

Rwanda adopted a new labour code in 2001 under Law 51/2001. Its main provisions regarding labour standards and the protection of workers mirror those of European economies. While many of these protective measures, particularly those regarding child labour, non-discrimination and the right to form trade unions,³⁷ are entirely legitimate and welcome, the code also introduces rigidities in hiring and firing procedures and in the organization of work that are not best fitted to Rwanda's economic stage of development and labour market conditions. The balance between the protection of existing workers in the formal sector and the need to create new job opportunities through flexible labour regulations is tilted excessively towards the former, particularly for a country where formal employment represents such a small share of the total labour force.

The World Bank's *Doing Business in 2006* ranks Rwanda 128th out of 154 countries on its overall "rigidity of employment index", which combines measures of rigidities in hiring, firing and numbers of

³⁶ While capital account transactions directly related to FDI have been liberalized, other (mostly debt-creating) operations remain subject to approval by the BNR. This includes external borrowing, foreign deposits in domestic banks and outward FDI.

³⁷ These provisions include a ban on formal employment for children below the age of 16 (with some exceptions allowed for children aged between 14 and 16) and on any discrimination based on gender, ethnic origin or religion.

hours worked.³⁸ Neighbouring Kenya and Uganda, in contrast, rank 40th and 15th, respectively, with most developed economies exhibiting a much higher degree of flexibility than Rwanda (table II.4).

Table II.4. Labour market rigidity index, 2005
(0 to 100, 100 = highest rigidity)

	Difficulty of hiring	Rigidity of hours	Difficulty of firing	Overall rigidity index
Rwanda	56	60	60	59
Kenya	33	20	30	28
South Africa	56	40	60	52
United Republic of Tanzania	67	80	60	69
Uganda	0	20	20	13
OECD	29.5	50.0	27.3	35.7
East Asia & Pacific	27.3	30.8	23.3	27.2
Latin America	42.5	53.3	31.0	42.2
Sub-Saharan Africa	48.1	63.2	47.8	53.1

Source: World Bank (2005a).

The main elements limiting labour market flexibility include:

- Fixed-term contracts are deemed indefinite contracts as soon as they are renewed for at least two successive terms, unless there has been an interruption requested by the worker. Fixed-term contracts are also limited to a maximum of two years. The three EAC countries have no limit on the duration of fixed-term contracts.
- The trial period during which an employee may be dismissed without compensation or formal justification is restricted to six months.
- Dismissals may lead to indemnities equivalent to up to 6 months of wage, or 1 year if the worker had been employed for more than 10 years. The average total firing cost (in weeks of wage) is estimated by the World Bank's *Doing Business* at 54 weeks, compared with 47 weeks in Kenya, 38 weeks in the United Republic of Tanzania and 12 weeks in Uganda.
- The contractual work-week may not exceed 40 hours, and any work in excess of that is considered overtime and must be compensated accordingly. Overtime is capped at 10 hours per week.

In addition to these provisions, Law 51/2001 provides for a minimum of 18 days of paid holiday per year and establishes a minimum wage (*salair minimum interprofessional garanti*, SMIG). It is currently set at a very low level and is not a constraint to hiring. Law 51/2001 also organizes the right of workers to form and join trade unions, as well as that of employers to form associations.

Labour disputes involving a single employee must be brought to conciliation within the company before any recourse to a labour inspector for another attempt at conciliation. Unresolved disputes are then referred to a competent tribunal. Collective disputes must be referred to a Conciliation Council before they can be referred to a tribunal. Similarly, strikes and lock-outs are considered illegal until an

³⁸ *Doing Business*, World Bank (<http://rru.worldbank.org/doingbusiness/>).

attempt at conciliation has been made and failed, and typically require a four-day notice. In any case, the right to strike may not infringe upon the right of other people to work.

As mentioned above, most workers' protection mechanisms in the law are entirely legitimate and welcome. Given the crucial need to generate additional formal sector employment and encourage informal sector activities to integrate the formal economy, it would be sensible for Rwanda to allow more flexibility in hiring and firing procedures and in the organization of the work-week, however. In particular: (1) provisions on fixed-term contracts could be relaxed, including the automatic conversion into indefinite contracts; (2) the trial period could be extended to a year or two;³⁹ (3) the organization of the work-week and workday is rigid even by European standards, and the situation of Rwanda warrants a higher degree of flexibility; and (4) firing procedures would gain from a higher degree of flexibility and lower cost. Far from reducing labour standards to low international standards, such increases in flexibility would bring Rwanda closer to international practice and could promote much-needed employment creation.

4. Employment of foreigners

Rwanda operates a "reactive" system of allocating work and residence permits to expatriates. Although it has not created major impediments to most existing foreign investors, the system is excessively restrictive in defining the types of skills that can be imported and it does nothing to *actively attract desired* skills. As illustrated in chapter I and further addressed in chapter III, one of the single most important barriers to development in Rwanda is the shortage of skills. Rather than *allowing* the import of skills, Rwanda should set up a *proactive skills attraction and dissemination programme* as a key foundation of its investment and development strategy. This scheme should incorporate concrete measures to optimize the dissemination of skills to nationals, thereby contributing to one of the main objectives of Vision 2020.

Under Law 17/99, work permits for expatriates are granted under two conditions: (1) proof that the employer could not find a national with appropriate skills to fill the position; and (2) the expatriate worker must hold a university degree and professional experience commensurate with the position. The first part of this procedure, known as "labour market testing", applies to every request for a work permit. Once the employer has been able to prove to the immigration authorities that there is no qualified national to fill the position, a one-year work permit may be issued. The work permit is separate from the residence permit, which must be obtained independently, also for one year.

Work and residence permits are each subject to a fee of Rwf200 000 (\$360) and may be renewed up to three times. Although the immigration administration has ensured that work and residence permits are delivered rapidly and relatively efficiently, the need to renew permits annually is placing an unnecessary burden on expatriates and employers, as well as on the administration itself. Limiting renewals to three also means that a foreign worker is limited to four year contracts at most, which is unduly short.

Employers are required to hire an "understudy" for each expatriate position. Under this scheme, the understudy is to be trained to replace the expatriate worker in due course. A report on the training of the understudy must be filed each time a work and residence permit is renewed (i.e. each year). Although this programme is aimed at transferring skills to nationals, its impact is limited as only a small number of people benefit from it and as it is rigid in terms of implementation.

In addition to the work and residence permits an employer may obtain through the normal channel,

³⁹ In August 2005, the trial period was extended to two years in France for workers in small companies (up to 20 employees), as one of the Government's key measures to introduce labour market flexibility and promote employment.

RIEPA-registered investors are entitled to three permits, as long as the investment exceeds \$100 000. The Investment and Export Promotion and Facilitation law of 2005 also introduced the possibility for an investor to obtain permanent residence, which is conditional upon him/her maintaining a minimum of \$500 000 on a term deposit in a Rwandan commercial bank. All expatriates are granted certain fiscal advantages upon initial installation in Rwanda, which consist mainly of the right to import one car for personal use and personal belongings free of duty.

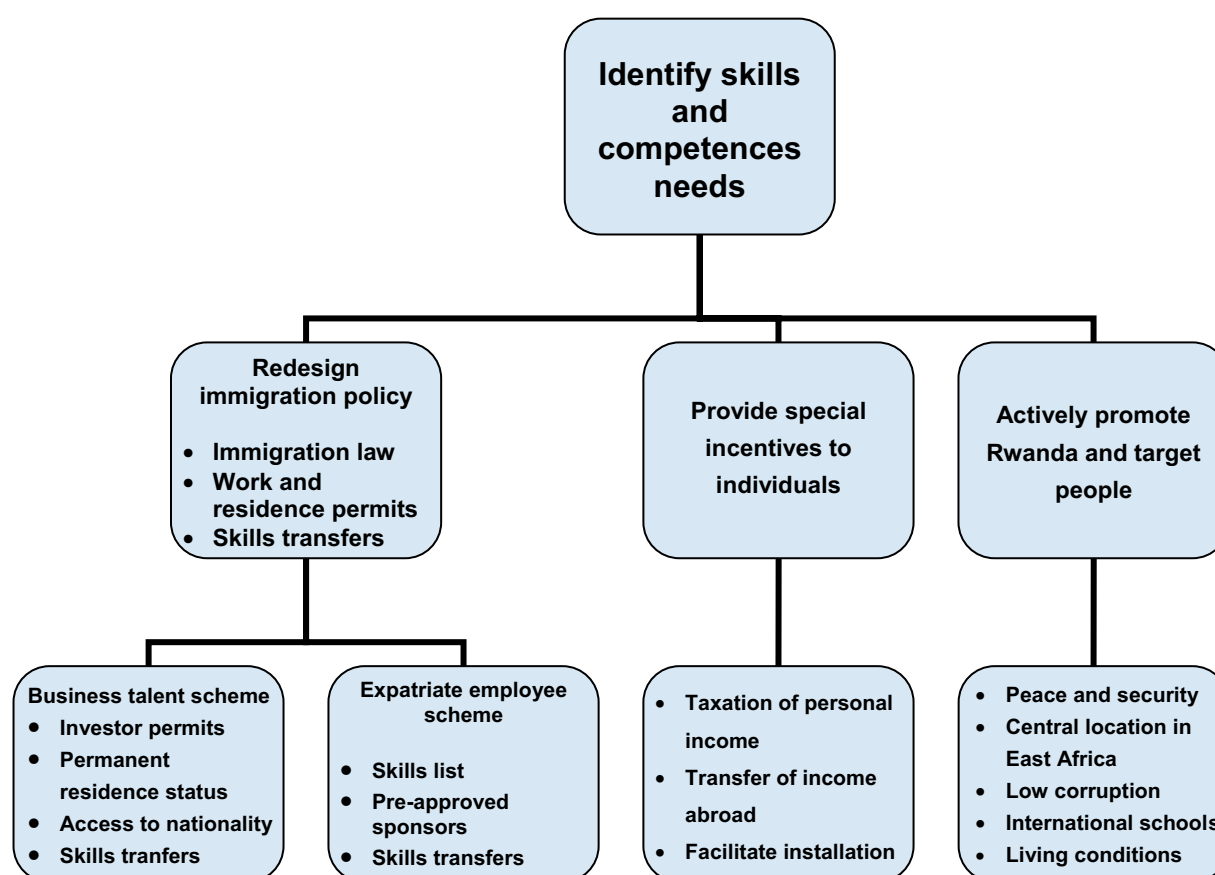
The current system is relatively well administered, but it is excessively restrictive in defining the skills that can be imported (a university degree is required). While it may not be an impediment to investors requiring expatriate managers, the existing scheme does not allow Rwanda to actively attract all the skills, competences and investment that it needs. A *proactive skills attraction and dissemination programme*, in contrast, could be at the core of a development and foreign investment promotion strategy. It would usefully complement and reinforce Government efforts (including with ODA support) to raise human capital through its forceful education policy. Given the small size of its economy and the limited development of the industrial and services sectors, Rwanda is more likely to attract individuals or family-based foreign investors and SMEs than large multinationals (chapter I). Such investors could generate a significant development impact and provide important entrepreneurial, management and technical skills. A skills attraction and dissemination programme could be articulated as follows (figure II.2).

a. Identify skills and competences needs

Rwanda's population is predominantly rural and possesses little formal skills or training in activities outside traditional agriculture (chapter I). The skills shortage extends to a wide span of fields and activities and is not limited to formal higher education (university training). The Government should first of all draw a list of skills and competences that are particularly needed, based on its national development agenda (Vision 2020 and PRSP). This list would underpin immigration policy and be re-assessed periodically. Given Rwanda's current situation, it should be widely defined and would encompass, at a minimum, the following skills, competences and sectors:

- Entrepreneurship;
- Infrastructure (utilities, telecommunications, transport): engineers, technicians, pilots, ground technicians, management, construction;
- Tourism: hotel management and employees, travel agency and tour operation, ancillary services (restaurants, bars, trekking, etc.);
- Agribusiness: management, technical skills, knowledge of markets and SPS;
- Services sector: legal services, accounting, consulting, banking, financial management, architecture, computer programming, land surveying, ICT and IT-enabled services;
- Mining: engineers, chemists, surveyors, machine operators, technicians, mechanics;
- Manufacturing: management, technicians, mechanics.

Figure II.2. Skills attraction and dissemination programme



b. Redesign immigration policy

Attracting business and entrepreneurship talent on an “individuals” basis calls for work permit schemes that are fundamentally distinct from those required to facilitate access to necessary competences by corporate entities. Redesigning immigration policy should thus focus on two schemes: (1) a business talent scheme; and (2) an expatriate employee scheme.

Business talent scheme

One of the key competences that Rwanda would benefit from attracting is entrepreneurship, which would bring associated skills, foster the densification and diversification of the industrial and services sectors and promote the transfer of skills to nationals. A business talent scheme aimed at attracting individual entrepreneurs could be structured along the following lines:

- Create "investor permits" for skilled individuals. A minimum capital requirement⁴⁰ would be established to screen *bona fide* investors. It should be associated with a list of desired skills. Investor permits could be made available in given numbers by types of sectors/skills if necessary, and the minimum capital requirement vary across sectors.

⁴⁰ The exact amount would have to be determined, but should initially remain relatively small as the capital requirement should be no more than a screening mechanism, and the investor's main contribution would be in terms of skills. An amount of \$25 000 could be considered initially and revised over time as the programme progresses.

- Provide permits for nuclear families. Individual investors need to be allowed to move to Rwanda with members of their nuclear families, who should also be permitted to work in the business.
- Provide certainty on permits. Individual investors need to have sufficient certainty that their permit will be renewed as long as the business is in operation. Clear guidelines and conditions as to how and under what conditions permanent residence status (or citizenship) can be gained should also be established.
- The investor permit should consolidate work and residence permits.

The new scheme established under the Investment and Export Promotion and Facilitation law of 2005 is a step in the right direction. It is not adequately structured to achieve the desired outcome, however, and does not have the features proposed above. In order to promote the integration and smooth assimilation of newcomers into Rwanda's social fabric, it would also be necessary to put in place a number of requirements and/or facilitation measures. These could include:

- Setting up a language test. Although investors attracted under the business talent scheme are likely to speak one of Rwanda's three official languages, this may not necessarily be the case. In order to ensure integration with local communities, obtaining the investor's permit could be made conditional upon demonstrating fluency in English, French or Kinyarwanda, or at the very least upon a commitment to learn one of them. In such a case, renewal of the permit could be made conditional upon demonstrating fluency after a period of about three years. Similar requirements could apply to all members of the nuclear family.
- ODA support could be sought from English- and French-speaking countries to establish evening programmes for adults in their respective language. Such partly or fully subsidized classes should be open to Rwandans and foreigners alike. They would be a good social integration tool for foreigners and would prove very useful for Rwandans as well, as English-French bilingualism among adults is still not widespread.

Expatriate employee scheme

Established companies may need skills that are not available domestically or in short supply. The second aspect of redesigning immigration policy should make the process of importing skills and competences in short supply as smooth and efficient as possible and provide a clear assessment of the skills needs. The dissemination of skills and competences to nationals should be maximized through well-targeted training requirements. Under the current immigration policy, most procedures for securing work and residence permits are “back-loaded” to the recruitment level. Under such a system, immigration decisions are taken at the (individual) recruitment level: labour market testing is carried out for each position, training requirements are programmed at the individual level and the corporate sponsor for the employee is assessed every time a request is made.

A “front-loaded” approach, in contrast, would bring many procedures and decisions forward in the decision-making process, hence avoiding unnecessary duplication at the individual level. Such a “front-loaded” approach would allocate work and residence permits as follows:

- Draw a list of skills that are in short supply at the national level. For these predetermined skills, the sponsor would not need to conduct individual labour-market test;

- Lift the requirement that the expatriate worker hold a university degree. This condition does not provide an appropriate benchmark to evaluate Rwanda's skills needs;
- Screen sponsors based on their track-record of good-practice in employing expatriate workers (training programmes for nationals, no excessive recourse to expatriate workforce, no overstays, etc.). Sponsors with a good track-record would be subject to less extensive verification than sponsors without track-record or with a poor one;
- Unify work and residence permits;
- Lengthen the period of issuance of the single permit from one-year to up to three years.

c. Set up training and transfer of skills requirements

The import of skills in short supply to support economic activity would benefit Rwanda in and of itself. Allowing foreign entrepreneurs to relocate to Rwanda and facilitating companies' hiring of foreign skills should nevertheless be accompanied by concrete mechanisms to maximize the dissemination of skills, know-how and competence to Rwandan nationals. At the moment, employers are required to put in place an understudy programme for each expatriate employee. A wider transfer of skills to nationals would be ensured with the following mechanism:

- Require entrepreneurs obtaining investors' permits to set up training schemes for national workers;
- Make training and localization a company-wide obligation in lieu of position-specific understudy programmes when expatriate workers are hired. Company-wide training programmes offer more flexibility and opportunities to transfer skills to the entire workforce than understudy programmes. Training obligations could be linked to the number of expatriate workers, turnover, or a combination of these and other factors. The status of a sponsor would also be linked to the quality and scope of its training programmes for nationals;
- Provide limited fiscal incentives for training programmes, including allowing over 100 per cent tax expensing of training costs.

d. Provide special incentives to individuals

In addition to a framework that *attracts* individuals, the Government would need to set up policies that *entice* them to move to Rwanda. A number of options could be considered, including:

- Duty-free imports of personal belongings upon installation (already in place);
- Non-resident status for personal income tax purposes for a limited number of years;
- Zero-rated (or lower rated) taxation on income earned overseas (e.g. earnings on assets held overseas);
- Deductibility for tax purposes of medical insurance and pension fund contributions overseas;
- Special provisions for the transfer of income abroad;
- Support services for installation (finding housing, schooling, medical care);
- Further encouraging the development of international schools, with curricula in English and French and international recognition of degrees.

e. Actively promote Rwanda and target people

Once an appropriate policy and regulatory framework has been put in place, the Government will need to actively promote Rwanda as a destination not just for investment, but for individuals to reside.

Given the synergies with general investment promotion, this function would best be carried out by RIEPA. It would involve a slightly adapted promotion and aftercare strategy, based both on investment opportunities and on the attractiveness of Rwanda as a place of residence. The promotion strategy could focus on the following assets:

- Central location in East and Central Africa;
- Peace, personal safety and stability;
- Low incidence of corruption;
- Pleasant living conditions;
- Availability of international schools and modern health facilities.

The Government has been very active over the past decade to entice Rwandans from the Diaspora to return and invest at home. Similar efforts to entice foreigners to reside and invest in Rwanda would best be targeted at individuals from within the region. In particular, investors of various ethnic origins in East and Central Africa, who already have a good knowledge of the region, are most likely to be open to the idea of moving to Rwanda with their skills and capital. A proactive promotion campaign would require providing information on the programme through a dedicated internal portal.⁴¹

5. Land

History, geography and population dynamics have made land issues particularly sensitive and complex in Rwanda. Population density is the highest in Africa and similar to the level in Belgium or Japan, and the population growth rate is one of the highest in the world (table II.5). The hilly nature of much of Rwanda's terrain also generates acute challenges for land use and preservation, and the potential to increase the availability of arable land is extremely limited.

Rwanda has also had to deal with the consequences of the 1994 genocide and previous displacements of population. Around 800 000 Rwandans from the Diaspora returned in the aftermath of the genocide, while around 2 million people fled to the Democratic Republic of the Congo and other neighbouring countries as the FPR forces took control of the country. Most of these refugees returned home in the mid- and late 1990s. This vast displacement of population over a short period of time has created particularly sensitive land ownership issues.

The Government recently elaborated a land policy and adopted a new land law in 2005 that seek to address these and other issues. It aims to provide a unified framework for property titles, which currently fall under a mix of customary law (governing most rural areas) and written law (governing parts of urban districts). The land policy and land law are carefully and well designed and should generate a significant improvement in land use, land management and property titles once implemented. Full implementation, however, is likely to take well over a decade under even optimistic scenarios. The main elements of the land policy and land law provide that:

- All land titles will be translated into written law, as customary land law will progressively cease to apply;
- A comprehensive land registration system and cadastral survey will be established progressively;

⁴¹ Singapore, which has a very elaborate skills attraction programme, has put in place such a portal: www.contactsingapore.org.sg

- Private property of land is allowed under renewable leasehold titles of up to 99 years. Land property can be sold, mortgaged or bequeathed at will;
- Natural resources in the sub-soil remain property of the State;
- Land will be classified as "rural" or "urban". Ownership over rural land will entail obligations to put it to productive and sustainable use (anti-erosion structures, improvement of its fertility);
- Foreigners will be conferred the same rights over land ownership as Rwandan citizens.

Table II.5. Land indicators (2002, unless indicated)

	Rwanda	Kenya	U. R. of Tanzania	Uganda
Population (millions) ¹	8.4	32.0	37.0	25.8
Population growth (%)	2.9	2.0	2.1	2.8
Population density (person/km ²)	330.9	55.1	39.8	124.8
Population in capital (millions)	0.6	2.2 ²	2.5	1.2
Rural population (% of total)	93.6	64.8	65.8	85.1
Urban population (% of total)	6.4	35.2	34.2	14.9
Arable land (% of total)	40.5	8.1	4.5	25.9
Arable land per person (ha)	0.13	0.15	0.12	0.21
Arable land in use (% of potential arable land)	156.8	28.5	5.2	48.0
Steeplands ³ (% of total)	75	48	49	47

¹ 2003.

² 1999 census.

³ Slope of 8 per cent or higher.

Sources: World Bank, World Development Indicators, IMF, International Financial Statistics, Food and Agriculture Organization and national sources.

In addition to this, the new land law provides that “the Government shall have the duty of finding land to give to those who have been deprived of their right to own land.” The Arusha Peace Agreement stipulated that refugees have the right to repossess their property upon their return, provided that it is reclaimed within at most 10 years. This provision implies that the Rwandan Diaspora that had been in exile for decades cannot reclaim property lost before the 1990s. It seeks to avoid the disruption that would be generated by moving people away from land or property they have occupied for an extended period of time, but obliges the Government to find suitable land for people returning from long-term exile. In contrast, refugees who fled Rwanda in the aftermath of the genocide and returned in the late 1990s and early 2000s were entitled to reclaim their property. Although all property issues have not been resolved, the return of refugees to their homes has been relatively smooth. Securing land property titles and providing land to the remaining landless Diaspora, in turn, should further strengthen peace and stability in Rwanda.

A sound policy and legal framework has thus been established, even though some accompanying regulations remain to be drafted. The success and impact of the new framework will also depend on the ability to implement the reforms. In particular, progress in establishing a cadastral survey and land

registration system will be crucial. This will require sustained efforts over a long period time and will be central to the Government's objective to ensure a productive, efficient and sustainable use of land.

6. Environmental regulations

The scarcity of natural resources, fragility of the environment and high density of population call for particularly careful management of environmental policy. In view of ensuring sustainable development, Rwanda filled an important gap in its legal framework in April 2005 by adopting Law 04/2005 on environmental protection. The Law establishes modern principles in environmental management of land, water, air, biodiversity, landscapes and natural sites. It institutes the principles of polluter-pays and precaution in face of uncertainty, and focuses on prevention of negative environmental consequences through *ex-ante* impact assessments.

Implementing rules and regulations are yet to be drafted that will define in details the types of projects that will require environmental impact assessments (EIAs) and their nature. Public works, mining and all projects involving land development will require EIAs. They will be assessed by the newly created Rwanda Environmental Management Authority (REMA), an autonomous body with broad supervisory powers. REMA will be financed partly by a tax of 0.5 per cent of the amount invested to be imposed on projects requiring EIAs.

7. Governance and judiciary system

Rwanda is widely – and rightly – perceived as having a low incidence of corruption.⁴² This is the result of a long-standing commitment from the highest sphere of Government not to tolerate corruption at any level. In 2003, Parliament adopted Law 23/2003 establishing sanctions ranging from 2 to 20 years imprisonment for passive and active corruption, together with fines ranging from twice to ten times the amount of the bribe. The Law also has provisions for penalties on legal entities (whether public or private), which include fines of up to ten times the amount of the bribe and exclusion from public contracts for up to 2 years. The law also seeks to prevent corrupt practices by requiring all public institutions to set up internal audit procedures, elaborate rules and timelines as to how and when decisions are taken, and recruit personnel through competitive examinations.

Investors assess the judicial system as generally fair, but not efficient. The most important constraint is the lack of resources and qualified personnel, which creates a backlog of cases and generates problems to render predictable and competent judgments. Few judges have the training and ability to rule on technical business issues. The World Bank's *Doing Business* also estimates the cost of enforcing contracts⁴³ at 43 per cent of the amount claimed. This compares to 22 per cent in Uganda, 41 per cent in sub-Saharan Africa, and 11 per in OECD countries.

The backlog of cases resulting from a large number of people still awaiting trial for crimes of genocide is also slowing judicial procedures, even though special Gacaca courts have now been established. The work of these courts is beyond the scope of this Review, but their success will be key to ensure a

⁴² This is confirmed by investors' interviews in Rwanda and Transparency International's 2005 Corruption Perception Index. Rwanda ranks 13th out of 44 African countries and 83rd out of 158 countries globally. The Rwanda index, however, is based on a survey of only 3 institutions (out of a possible 16 sampled by Transparency International to build its index). This means that the interval of confidence for the Rwanda index is wider than for most other countries, whose index is based on a survey of a larger number of institutions. A wider sampling for Rwanda could thus place it in a more favourable position still.

⁴³ Cost of enforcing payment of an amount equivalent to 200 per cent of income per capita, assuming that the plaintiff is fully in his/her right and that there is no appeals to the judgement.

lasting reconciliation and to building a strong judiciary system. The Government is also making significant efforts to improve commercial justice. It set up an arbitration mechanism in 2004 that has become operational following the training of 38 arbitrators and the establishment of the physical infrastructure. The Government is now working to establish commercial courts in Kigali, Ruhengeri and Butare. Judges have been trained and equipment provided, but the courts are not fully operational yet.

This has the potential to greatly improve the efficiency of the judicial system for investors. Additional measures would still be necessary, however, including:

- Further training of judges;
- Modernizing some key commercial laws and regulations. The Government took a first step in that direction by creating a business law reform commission in September 2005;
- Improving the precision and clarity in the drafting of key commercial laws;
- Ensuring the strict equivalence of all three language versions of the laws.

8. Competition regulation

Some provisions on competition are contained in Law 51/2001 on the organization of domestic trade. It specifies that prices are set freely by market forces as a rule, but that the Minister of Commerce, Industry, Investment Promotion, Tourism and Cooperatives has the authority to regulate prices in three cases: (1) monopolies established in view of avoiding speculation in certain sensitive products; (2) monopolies in the production or distribution of specific products; and (3) *de facto* monopolies on consumer goods and services.

Law 51/2001 specifically forbids practices that distort market prices or seek to establish a monopoly. Illegal practices are defined mainly as: (1) implicit or explicit agreements that seek to impede the free movement of goods or services, including refusal to sell and discrimination between buyers; (2) practices that seek to artificially prevent prices from falling; and (3) practices that seek to artificially increase market prices. The law also requires prices to be clearly and publicly displayed.

While Law 51/2001 contains the skeleton of a competition law, many key elements are missing, including in terms of trade practices, M&As, price setting in monopolistic markets and supervision. At present, civil servants at the Ministry of Commerce are in charge of enforcing rules on pricing and competition as no independent competition agency has been established.

Although it may not be urgent to set up an independent competition authority given resource constraints, it is important for Rwanda to devise a competition policy and associated law and regulations. The small size and limited development of the industrial and tertiary sectors make it more likely that existing or new companies be in *de facto* monopolistic situation or enjoy dominant market power. Under such circumstances, it is essential that the authorities be in a position to efficiently monitor, supervise and regulate the price setting and market behaviours of dominant firms. Putting Rwanda in such a position will require drafting proper competition law and regulations and eventually set up a supervisory body. The key elements that will have to be added to the skeleton formed by Law 51/2001 include:

- Provisions as to how much market dominance is to be tolerated. A simple competition maximization policy is not likely to be achievable or desirable: given the small size of Rwanda's economy, some degree of market dominance is inevitable;

- Provisions for mergers and acquisitions;
- More detailed provisions regarding anti-competitive trade practices;
- Mechanisms to monitor and regulate prices in markets with high concentration of power;
- Monitoring and enforcement mechanisms;
- Coordination with the Rwanda Utilities Regulatory Agency (RURA).

9. Intellectual property law

Rwanda's main legislation regulating industrial property dates back to 1963. Although it provides for some essential protection for patents, trade marks and industrial designs, including 20 years non-renewable exclusivity for patent holders, the law is no longer in accordance with international standards. Copyright protection, in turn, is regulated by a law dating back to 1983. Rwanda has been a member of the World Intellectual Property Organization (WIPO), the Paris Convention on industrial property and the Berne Convention on literary and artistic works since 1984.

As a member of the WTO, Rwanda is a signatory to the Trade-related Aspects of Intellectual Property Rights (TRIPS) agreement. As a least-developed country, it was initially given until 1 January 2006 to bring national legislation into compliance with TRIPS provisions. In late November 2005, however, the WTO extended the deadline for LDCs to comply with TRIPS to 1 July 2013.⁴⁴ The current law has not been a hurdle to domestic or foreign investment so far, and is unlikely to be so in the near future. Rwanda has nevertheless started drafting a new law with technical assistance from WIPO, which should bring it into compliance with TRIPS requirements.

10. Corporate governance and accounting standards

The drive to modernize the legal system has yet to extend to a number of commercial laws, which remain obsolete and inappropriate for a private-sector driven economy. Company, bankruptcy and contract laws date back from the 1960s or prior to independence and are no longer appropriate to today's business environment. Similarly, Rwanda does not have a well-established set of accounting standards, and reporting and disclosure requirements are very limited, even for larger companies.⁴⁵ Under such circumstances, Rwanda has obviously not put in place any legal requirement in terms of corporate social responsibility. Such requirements should not be a priority at this stage, as the focus should be on enforcing compliance with general business regulations. The few larger companies invested in Rwanda have also started corporate social responsibility programmes of their own.⁴⁶

Government efforts to establish commercial courts (section D.7) will generate significant payoffs only if the judiciary is equipped with appropriate commercial laws to enforce. Modernizing commercial laws should be articulated around two main purposes:

- Facilitate the establishment of companies, big or small. This will require adapting the legal framework to allow the creation of firms under a variety of capital and liability structures, as well as streamlining set-up procedures. Such efforts will be vital to entice businesses in the informal sector to enter the formal economy.

⁴⁴ The deadline for LDCs to provide patent protection for pharmaceutical products remains unchanged at 1 January 2016.

⁴⁵ Rwanda scores only 1 out of a maximum of 7 on the World Bank's *Doing Business* index of investor protection. For example, indirect, family or beneficial ownership in private companies need not be disclosed. Neither does information on voting agreements between shareholders.

⁴⁶ This includes social projects by MTN RwandaCell or Terracom, the two largest private telecommunications companies.

- Facilitate business transactions and enhance transparency. This will demand a balancing act between raising reporting and disclosure requirements for larger businesses and avoiding an excessive burden on businesses, particularly smaller ones. It will also require clear and predictable contract laws and impartial implementation by commercial courts.

The legislative actions that are called for include the adoption of: (1) a new company law; (2) a new bankruptcy law; and (3) a new contract law. In addition, the Government should promote the use of the recently created arbitration mechanisms so as to lighten the burden of formal court proceedings.

11. Selected sectoral regulations

Rwanda has started to reform some key sectoral laws. It adopted a revised framework for telecommunications and established an independent cross-sectoral regulatory agency, the Rwanda Utilities Regulatory Agency (RURA), in 2001. Law 39/2001 gives RURA the mandate to supervise and regulate: (1) telecommunications; (2) electricity; (3) water; (4) waste management; (5) gas extraction and distribution; and (6) transport (of persons as well as goods).

RURA has the mandate to ensure the application of sectoral laws and regulations, to foster loyal competition and protect consumers against abuses where a monopoly situation prevails and to facilitate and encourage private investment. The competition role is emphasized by Law 39/2001 as RURA is expected to closely monitor pricing and trade practices in the six sectors mentioned above, and it has been given genuine enforcement power. Anti-competitive practices are broadly defined to include price fixing, discrimination among buyers, restriction of access, abusive contractual obligations and technical barriers to entry. The law also incorporates provisions to avoid further strengthening of dominant market positions. RURA has the power to ban anti-competitive practices, impose fines,⁴⁷ and void a contract between parties.

The establishment of RURA is a very welcome development, and it is sensible to integrate the regulatory functions of a wide range of sectors into a single agency. This should allow not only a better use of limited resources and capacity, but also allow a steeper learning curve for regulators. The effectiveness of RURA will become more and more important in the future as market forces and the private sector increase their role in infrastructure. A successful dismantling of state monopolies in the utilities sector will raise the need for competent and efficient regulation and supervision. It will be crucial, in that respect, that RURA be given the resources it needs to perform its functions and that it be backed by a modern set of laws and regulations to enforce. While a new regulatory framework has already been adopted in telecommunications, similar modernization will have to take place for power, water, and transport for RURA to be effective.

a. Telecommunications

The telecommunications sector remains small and under-developed, but the Government has made it a priority. It sees it as an essential backbone service for the development of a competitive economy, as well as a source of growth and employment in its own. RURA estimates the penetration rate of fixed and mobile telephony at 1.6 per 100 inhabitants. This amounts to less than 23 000 fixed line subscribers and close to 140 000 mobile phone subscribers (table II.6). Mobile phone subscribers have more than tripled between 2001 and 2004, however, as the quality and availability of service has been much higher

⁴⁷ Depending on the practice, fines range between Rwf200 000 (\$350) and Rwf5 million (\$9000) per day.

than for fixed line telephony. Similarly, only about 0.1 per cent of households have a computer at home, and the total number of internet subscribers remains below 3000 for the country as a whole.

The telecom market is dominated by two main operators: Rwandatel, the fixed line operator, and MTN Rwandacell, the mobile phone operator. Rwandatel was fully government-owned until June 2005, when it was sold for \$20 million to Terracom, a foreign-owned internet services provider (ISP). The Government strategy seeks to transform the telecom sector through increased private sector investment and competition under a modern legal and regulatory framework, which was introduced under Law 44/2001 in November 2001. The law provides a set of rules and regulations that reflect modern regulatory approaches and are appropriate to the structure of Rwanda's telecommunications sector. In order to increase competition, the Government granted a mobile licence to Terracom and allowed MTN Rwandacell to operate as a fixed-line operator.

Table II.6. Telecommunications indicators

	2001	2002	2003	2004
Subscribers (active lines)				
Rwandatel (fixed)	21 458	25 105	25 565	22 972
MTN Rwandacell (mobile)	44 117	82 391	97 261	137 271
Internet subscribers	1 482	2 047	2 504	2 875
Turnover (million dollars)				
Rwandatel	17.5	17.7	19.7	..
MTN Rwandacell	25.4	28.3	28.5	..
Tariffs (Rwf per minute)^{1,2}				
Mobile - fixed	..	..	120 (0.22)	132 (0.23)
Mobile - mobile	..	..	88 (0.16)	97 (0.17)
Fixed - fixed (urban)	..	..	14 (0.03)	14 (0.02)
Fixed, int'l - EU	..	..	..	525 (0.91)
Fixed, int'l - USA	..	..	..	465 (0.81)
Mobile, int'l - East Africa	..	..	..	250 (0.44)
Mobile, int'l - rest of world	..	..	..	400 (0.70)

¹ Cost in US dollars in brackets.

² Prices exclude VAT of 18 per cent.

Sources: Rwanda Utilities Regulatory Agency, MTN Rwandacell and Rwandatel.

RURA has a number of powers to control prices and trading practices, including the ability to enforce price controls so that prices reflect cost and "reasonable profit" for companies that dominate a segment of the market, as well as the ability impose interconnectivity between operators. Interconnectivity is particularly sensitive in countries where competition does not yet prevail and where a dominant market player may not allow interconnectivity at reasonable cost. RURA's role under Law 44/2001 is to mediate where companies cannot find an agreement, and to enforce one if mediation efforts fail.

RURA also monitors pricing and trade practices (including number portability, restrictive technical barriers and termination charges) and grants licences. It manages a universal access fund that was created in order to provide access to telecommunications infrastructure to rural areas. The fund is financed by a 2 per cent turnover tax on all operators. In 2004, close to \$800 000 was raised for the fund, with about 80 per cent allocated to Artel, a private company, to finance pilot telephony projects in 44 rural areas.

Law 44/2001 has equipped Rwanda with a modern and appropriate tool to develop the telecommunications sector through private investment. Such investment will be essential for competition to emerge, as the sector is still dominated by monopolistic operators in the fixed lines, mobile and international telephony segments, and by a small number of ISPs. Although a second mobile operator should emerge soon, RURA's regulatory and monitoring role will be crucial to the quality and cost of services for the foreseeable future. It is encouraging in that respect that the cost of mobile telecommunications in Rwanda is competitive when compared to other countries in the region (table II.7).

Table II.7. Cost of mobile telecommunications, 2005

(Pre-paid base, \$ per minute)¹

	mobile - mobile ²	mobile -fixed	mobile - United States	mobile- int'l (regional)
Rwanda	0.17	0.23	0.70	0.44
Democratic Republic of the Congo	0.24	0.28	0.40	0.28
Kenya	0.21	0.33	1.45	0.63
South Africa	0.40	0.40	0.76	0.47
United Republic of Tanzania	0.23	0.30	1.01	0.37
Uganda	0.21	0.21	0.56	0.49

¹ Prices are based on pre-paid plans for all countries, based on peak-time calls. For better comparisons, the same providers are used where available: MTN for Rwanda and South Africa, Celtel for all other countries.

² Calls within the same operator.

Sources: MTN and Celtel websites.

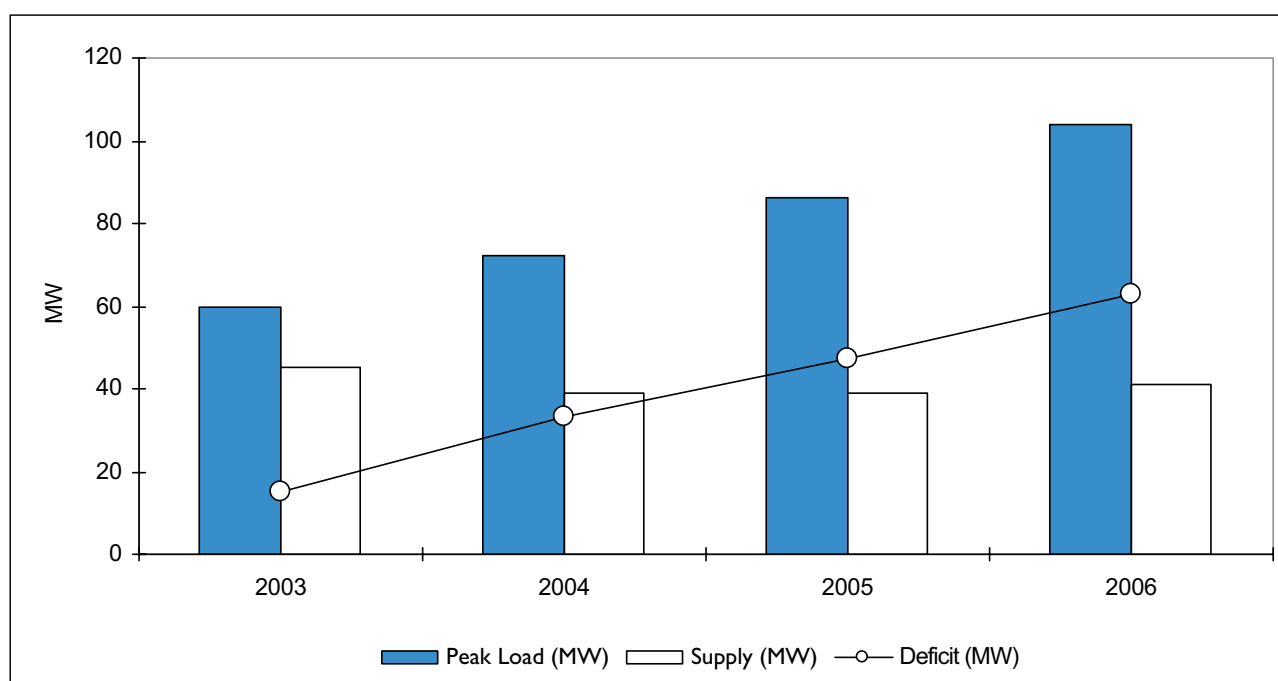
b. Electricity

Insufficient and unreliable electricity supply is likely the most serious infrastructure constraint to both domestic and foreign investment. All electricity infrastructure (generation, transmission, distribution and micro-power units) was damaged during the genocide, and no new investment in bulk generation capacity took place between 1982 and 2004. Generation capacity is well below national demand, and the interconnectivity with the regional grid is poor and does not extend to the main excess producing countries. This has led to systematic load-shedding across the country, frequent power outages outside scheduled load-shedding times, power surges and high prices (figure II.3).

The Government has little capacity to invest in new infrastructure, and is determined to promote private investment in the power sector instead. At the moment, the entire sector (generation, transmission and distribution) is operated by Electrogaz, a 100 per cent government-owned company, which is also responsible for the water sector. Electrogaz has a generation capacity of 43 megawatts (MW), which is

dominated by hydro-electric plants. This has been at the source of problems recently, with low water levels limiting output. In order to fill some of the supply gap, the Government commissioned two diesel generators in late 2004, which have a very high operating cost. The lack of maintenance and new investments on the transmission and distribution networks have also generated high technical losses, which amounted to about one-third of output in recent years.

Figure II.3. Electricity supply, demand and shortage
(Megawatts, 2003-2006)



Source: Ministry of Infrastructure.

As a first step towards the involvement of the private sector in the power sector, Lahmeyer International – a German consulting engineering company – was awarded a 5-year management contract for Electrogaz in September 2003. Lahmeyer is to turn Electrogaz into an enterprise in corporate form suitable for private investment, and to restructure and expand the electricity and water system. More specifically, it is expected to: (1) provide a baseline assessment of Electrogaz; (2) set up a business plan; (3) introduce a technical- and commercial-loss reduction programme; (4) initiate a tariff review; and (5) analyse independent power producers (IPPs) options. Ownership and the responsibility to finance investments fully remain in government's hands, however.

A key element of Lahmeyer's contract is to revise the tariff structure. At the moment, a single price is charged to all consumers, regardless of total consumption and whether it is peak/off-peak. Electricity was charged at Rwf42 (¢7.4) per kilowatt-hour (kwh) until December 2004, when Electrogaz was allowed to raise the price to Rwf82 (¢14.5)⁴⁸ in order to reflect high production costs. The price was further increased in 2006 to Rwf112 (¢19.8) following rising diesel prices.

⁴⁸ Excluding VAT of 18 per cent.

The Government of Rwanda recently entered into a joint venture with Dane Associates (an Israeli-Swedish group) to produce electricity from methane gas in lake Kivu.⁴⁹ Under the IPP contract, the company will be licensed to extract up to 60 million cubic metres of gas. It is scheduled to produce up to 39 MW when fully on-stream, likely towards the end of 2007. A power purchase agreement (PPA) was signed with Electrogaz for 25 years. The Government provides a guarantee and purchase prices by Electrogaz are denominated in euros. When operational, the power plant should go a long way towards alleviating some of the supply shortage. It should also contribute to lower electricity prices, as the fuel cost of generation is estimated at around ¢2.5 per kwh for methane gas, compared to ¢15 per kwh for light oil.

Government efforts to involve private investors in the power sector must be commended. In order to ensure that private involvement takes place in an orderly and pro-competitive manner, however, a modern legal and regulatory framework should be put in place, similarly what took place in the telecommunications sector. Contractual arrangements may temporarily provide a means to involve private investors, but they should not substitute for a comprehensive legal framework. Such a framework would likely entail the division of the sector into its generation, transmission and distribution segments, each with a varying degree of private sector involvement and competition. Innovative solutions to allow consumers with their own generation capacity to re-inject excess production onto the grid could also be envisaged. Building technical capacity at RURA to oversee the sector will also be vital.

c. Banking system

Rwanda's banking system reflects the size and rural nature of the economy in that it remains small and unsophisticated. However, three privately owned banks have been created since 1995 and the authorities have made significant efforts to improve the regulatory framework in recent years. These efforts have resulted in a stronger banking system, even though major weaknesses in terms of capitalization, asset quality and provisioning persist at some of the banks.

The banking system consists of six commercial banks and three development or cooperative banks. Foreign institutions (private or public) have control or significant interests in four of these, while the public sector (government or parastatals) remains invested in five of them (table II.8). The largest three commercial banks represent 66 per cent of deposits and 57 per cent of loans. Total assets of deposit money banks represented only \$450 million at the end of 2004, with credits to the private sector accounting for about half of these (table II.9). External assets, in turn, represented close to 25 per cent of total assets, reflecting sizeable foreign currency deposits.

⁴⁹ The Government owns 30 per cent of the equity, while Dane Associates owns 70 per cent. The project also benefits from a partial risk guarantee from the World Bank. The total project cost is estimated at around \$80 million.

Table II.8. Banking system

	Market share of deposits (per cent)	Market share of loans (per cent)	Ownership structure
Banque de Kigali	26.2	22.6	50% Belgolaise (Fortis, Belgium-Holland) ¹ , 50% public
BCDI	22.2	19.6	100% private (local non-corporate owners)
BCR	17.2	15.0	80% CDC group (U.K.), 20% public
BANCOR	7.3	8.6	100% private
BACAR	8.3	9.1	60% FINA Bank (Kenya), 20% Enterprise holdings (Botswana), 20% public
COGEBANQUE	3.4	5.1	100% private
UBPR	9.7	12.8	100% private (local cooperative bank)
BRD	5.3	7.1	55.7% public, 10.5% private (local), 33.8% foreign development agencies
CHR	0.5	0.0	83% public, 17% private (local)

¹ The Fortis Group decided to withdraw from Belgolaise in 2005 and has started to divest from its network of African subsidiaries.

Sources: Banque National du Rwanda, IMF, company websites.

Wide regulatory and supervisory powers are granted to the BNR under Law 11/97 regulating its statutes and Law 08/99 regulating banks and other financial institutions. It has used these powers to put in place relatively strict and restrictive regulations that have left little room for the banking system to put in place innovative financial instruments. Such a restrictive approach was justified by the fragility of the banking system in the aftermath of the genocide. At this stage, however, a somewhat more «hands-off» approach to regulations should be feasible without generating undue systemic risk. Such an approach, in turn, could foster the development of new instruments and a more sophisticated banking system that could benefit the economy as a whole (chapter III).

The main prudential regulations enforced by the BNR include:

- Banks are required to put in place a loan classification system whereby assets are ranked from class 1 ("current") to class 5 ("contentious").⁵⁰ Classification of loans under class 3, 4 or 5 requires immediate provisioning of 20 per cent, 50 per cent and 100 per cent, respectively;
- Banks are required to communicate to the BNR and other banks the list of debtors with loans in excess of Rwf 500 000 (\$900) in class 3, 4 or 5. It is strictly forbidden for any bank to extend further credits to these debtors;

⁵⁰ Class 1: no delays in interest and principal payments and financially strong debtor.

Class 2: delays in interest or principal payments between 30 days and 90 days, or deteriorating financial situation of the debtor.

Class 3: delays in interest or principal payments between 90 days and 180 days, or important doubts about the financial situation of the debtor.

Class 4: delays in interest or principal payments between 180 days and 360 days, or serious doubts about the financial situation of the debtor.

Class 5: delays in interest or principal payments in excess of 360 days.

Table II.9. Banking sector indicators
(Millions of dollars)

	2001	2002	2003	2004
Assets	344.2	369.0	376.7	452.6
Reserves	34.4	26.4	24.3	28.1
External assets	76.2	82.3	92.6	105.2
Credits to the private sector	170.8	174.3	175.9	230.6
Credits to public sector	19.4	37.7	36.9	44.4
Other	43.3	48.3	47.0	44.3
Liabilities	344.2	369.0	376.7	452.6
Sight deposits	86.7	94.5	94.6	106.3
Term deposits	60.7	83.2	71.2	93.0
Foreign currency deposits	62.9	61.8	77.3	88.3
External liabilities	10.5	17.0	20.7	18.2
Other	123.4	112.6	112.9	146.8
Non-performing loans ratio ¹	36.9	33.7	30.3	..

¹ As a percentage of total loans.

Sources: Banque National du Rwanda and IMF.

- Banks' exposure to a single debtor (or group of debtors) may not exceed 25 per cent of capital. This may be a problem in an economy with very few major corporate clients and where credit to agriculture is almost exclusively focused on tea and coffee;
- Banks are required to set up systems to allow them to measure a range of risks, including credit risk, market risk, liquidity risk and exchange rate risk;
- Capital account transactions with non-residents are strictly regulated. Inward FDI and foreign purchases of Treasury Bills are encouraged, while outward FDI and external borrowing by residents is allowed only after approval by the BNR. Similarly, all other capital account transactions with non-residents require prior BNR approval. This would include banks opening accounts for non-residents or lending in foreign currency to non-residents.

d. Mining

Rwanda's mining sector is composed of a few small and low-technology industrial mines and a large number of artisanal miners. Industrial mining is dominated by government-owned Régie d'Exploitation et de Développement des Mines (Redemi), which was created in 1988 on the ashes of the bankrupt Société des Mines du Rwanda. It currently holds 20 concessions covering about 1000 square kilometres and produce mostly cassiterite, coltan and wolfram. In 2000, it had about 500 full-time employees and a turnover of \$1.3 million. Redemi's physical and human infrastructure was severely damaged by the genocide in 1994, and the Government has been unable and unwilling to inject much new capital.

Rwanda does not have an up-to-date geological survey, as most geological work was conducted before independence and did not cover hard rock potential. The geophysical characteristics of Rwanda and the proven mining resources of its neighbours with similar conditions indicate that the mining potential may be significant, however. The Government recognizes that it is not in a position to conduct

a modern geological survey and that it will have to rely on the private sector to explore the mining potential of the country. With that in view, it is preparing a new mining code for adoption by Parliament. The draft law includes most of the fundamental requirements to attract private investment in minerals exploration and mining, but would benefit from some relatively minor changes before it is adopted in order to better safeguard Rwanda's interest and/or provide more certainty and predictability to potential investors (box II.2).

The draft law includes provisions to enable mining companies to enter into early stage agreements that give contractual form to their rights and obligations and to stabilize the fiscal regime. Such provisions should be especially attractive as exploration and mining are long term, high-risk investments. Once the law is adopted, it will greatly assist the promotion of investment in mining for the Government to issue a model form of this agreement.

In contrast, the draft law does not include any provision on royalties or tax arrangements. Particular care will have to be given in that respect when rules are devised, so as to protect Rwanda's interest while at the same time providing a package geared to attracting pioneering investors. It will be advisable for Rwanda to seek technical assistance in devising the fiscal arrangements (corporate tax, royalties, depreciation allowances, foreign exchange accounting, foreign exchange retention) for the mining sector. Such assistance is currently being provided by UNCTAD to the Ministry of Lands, Environment, Forestry, Water and Mines.⁵¹

12. Privatization

The Government launched a privatization programme in 1996 under Law 02/96. It earmarked 75 public enterprises for sale or liquidation in a variety of sectors. Of these, 40 had been privatized by September 2005. A relatively strict set of procedures has been put in place to promote transparency in the sale of public assets and gain public support for the programme. These include the separation of functions between the privatization secretariat in charge of the sales procedures, a technical committee in charge of evaluating tenders and negotiating with buyers, and a national commission in charge of setting policy and overseeing the programme.

All sales of Government assets are subject to public tender whereby interested buyers must submit separate technical and financial bids. The two bids are evaluated separately and in sequence, with the submission of an unsatisfactory technical bid being disqualified regardless of the financial bid. The privatization programme and Government efforts to inform and educate the population about it have so far yielded positive results. In order to ensure that privatization results in higher quality goods and services at a competitive cost, the Government nevertheless needs to strengthen the regulatory framework and institutions in certain areas. This is particularly the case as privatization is extending to the telecommunications and utilities sectors.

⁵¹ UNCTAD (2006). Strategy for the Promotion of the Industrial Mining Sector or Rwanda.

Box II.2. Suggested changes to the draft mining law

The key changes that could be introduced to the draft mining law in view of better protecting Rwanda's interest and increasing its attractiveness to foreign investors are:

- The draft law grants exclusive licences for prospecting, which is unusual. Exclusivity means that large areas will be off-limits for other reconnaissance or exploration activities for a significant period. Given the poor state of Rwanda's geological survey, *exclusivity* for prospecting licences is not in the country's interest. It is also not a provision that international investors would expect. Prospecting licences should thus be non-exclusive, as this would better serve Rwanda's interest and would not deter private investment.
- A general provision should be made in the draft law for information gained during prospecting to be furnished to the authorities, who will make the information publicly available when the prospecting licence expires. This is a standard requirement in most countries. It improves the geological survey without deterring private investment.
- The draft law provides that *exploration* licences are issued for up to four years, renewable once, and over a maximum area of 4 square kilometres. This is restrictive and may not be in the Government's interests since Rwanda's hard rock mineral potential at depth is lightly explored. An alternative approach would be to grant exploration licences over larger areas but with relinquishment obligations (e.g. 50 per cent of surface area every two years). When areas are relinquished, all information reverts to the government for open access and this process helps to fill in gaps in the geological survey. Provided that relinquishment is taking place there is no need to prohibit more than one renewal.
- A fundamental requirement for a private investor is that the work and expense involved in finding a commercial deposit gives it the *right* to be granted a mining concession, subject to providing acceptable mining, financing and environmental plans. This principle should be contained in the law, including the key requirements to be satisfied. There should be rights of appeal against rejection of an application for a mining concession.
- The draft law allows the transfer of exploration licences and mining concessions. The conditions under which this is authorized require more definition. A widely used approach is to say that titles may be transferred subject to the responsible minister's approval, such approval not to be unreasonably withheld. The matters to be assessed by the Minister should be explicit, for example whether the transferee has the financial and technical capacity to meet licence obligations. The provisions should also more explicitly cover "farm-ins" – which may result either in changed ownership of the title-holding entity or joint holding of a title. These are necessary to accommodate conventional business arrangements in the industry.
- Regulations to the proposed law will set out the royalties payable. It is important that schedule royalty rates be set at the time the act is published. Royalties should not be left for case-by-case negotiation.

Sources: Draft mining law and UNCTAD.

13. Trade agreements

The Government is pursuing an active policy of trade integration with regional partners and has preferential access to the EU and US markets. Rwanda has also been a member of the WTO since 1996, and had previously been a member of the GATT since 1966. As a result of these agreements, Rwanda benefits from extensive preferential access to key markets. This has been insufficient so far to generate a large export sector, however, mostly because of the limited level of industrial development and export capacity (chapter I).

Rwanda has been eligible to the preferential market access granted by the United States under the African Growth and Opportunity Act (AGOA) since its inception in October 2000. AGOA grants duty-free access without limitation of quantity to the United States for about 6400 tariff line items, 1800 more than under the standard Generalized System of Preferences (GSP). The preferences, initially scheduled to end in September 2008, were extended to September 2015 under the second AGOA amendment in July 2004.

The United States also granted special preferences to Rwanda for apparel exports⁵² starting in March 2003. In spite of this, however, exports to the United States almost exclusively consist of tea, coffee and ores⁵³ (table II.10). Similarly, Rwanda benefits from tariff-free and quota-free access to the EU market on virtually all goods under the Everything But Arms (EBA) initiative. Although exports to the EU are slightly more diversified, the bulk of exports also consist of coffee, tea and ores.

The Government is aware that few local firms are likely to be competitive in the short- to medium-term in the production of high value-added goods for exports to the United States and the European Union, and that exports to these markets will likely remain dominated by tea, coffee and a few other traditional goods or commodities. As a result, it has rightly decided to extend its network of trade agreements within the region. Rwanda joined the free-trade area made up of a sub-group of 11 COMESA member states⁵⁴ in 2004, and it had been a member of the Common Market for Eastern and Southern Africa (COMESA)⁵⁵ from the start in 1994.

Additionally, Rwanda recently applied for membership to the East African Community, at the same time as Burundi. The EAC, which currently consists of Kenya, Uganda and the United Republic of Tanzania established a Customs union on 1 January 2005, with three tariff bands of 0, 10 and 25 per cent. Free trade among the three current Member States will be established over a period of five years, as Kenya agreed that some of its manufactured goods remain subject to tariffs for the transitional period on account of the more advanced state of its manufacturing sector relative to the United Republic of Tanzania and Uganda. Rwanda and Burundi's membership to the EAC is currently under negotiation, and an agreement could be found in 2006.

⁵² These preferences allow duty-free access to the United States for six types of apparel, subject to certain quantity limitations (on duty-free imports, not on imports in general) applied on an AGOA-wide basis. Rules of origins are also relaxed as duty-free access is granted to apparel made from fabrics imported from non-AGOA countries. This flexibility on the application of rules of origin for preferential access will end in September 2007, however.

⁵³ Mostly tungsten ores and concentrates.

⁵⁴ Burundi, Djibouti, Egypt, Kenya, Madagascar, Malawi, Mauritius, Rwanda, Sudan, Zambia and Zimbabwe.

⁵⁵ COMESA includes the following countries: Angola, Burundi, Comoros, Democratic Republic of the Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia, and Zimbabwe.

Table II.10. Exports to the United States and the European Union
(Millions of dollars)

	2001	2002	2003	2004
United States	7.61	3.31	2.88	5.80
Coffee	0.00	0.04	0.03	0.00
Tea	4.00	2.05	1.95	4.90
Ores, slag and ash	3.16	0.98	0.63	0.69
Other	0.44	0.24	0.27	0.22
European Union ¹	47.18	22.29	21.30	29.16
Coffee	14.80	14.55	12.30	23.19
Tea	1.31	1.89	0.77	1.36
Live trees and other plants	2.99	0.82	0.11	0.47
Ores, slag and ash	0.41	0.98	0.55	1.07
Raw hides, skin and leather	0.65	0.75	0.37	0.59
Other	27.02	3.29	7.21	2.49

¹ 25 members States.

Sources: US International Trade Commission and Eurostat.

Recognizing the rising importance of South Africa as a trade partner and source of investment, Rwanda entered into a bilateral framework agreement that covers a number of issues, from trade to investment and cultural or educational exchanges. In addition to this bilateral agreement with South Africa, Rwanda recently applied to the Southern African Development Community (SADC).⁵⁶ While SADC's objectives go well beyond the removal of trade barriers, the group is still a number of years away from even establishing a free-trade area.

E. Assessment and recommendations

Rwanda faces particular challenges to attract foreign investment given the small size and low level of development of its economy, poor infrastructure, low level of human capital and limited natural resources. As a consequence, it must strive to make the most of all its assets and aim to eliminate all "soft" constraints that unnecessarily hinder investment. Appropriately enough, one of Rwanda's key assets is the Government's awareness of the need to put in place a private-sector friendly legal and regulatory framework, and its willingness and commitment to work in that direction. Rwanda should thus strive to achieve the highest standards in legal and regulatory issues, i.e. do *everything* well (and *better* than its larger neighbours and competitors) in order to position itself as a *centre of excellence in soft infrastructure and governance*.

Striving to do everything well should not disguise the need to prioritize, however, as capacity and resources constraints are strong, and many aspects of the investment framework need modernization despite the efforts that have been carried out so far. The key priorities for reforms in the legal and regulatory framework identified in this chapter are described below. They should underpin the FDI strategy and the development of a strong domestic private sector.

⁵⁶ SADC includes Angola, Botswana, Democratic Republic of the Congo, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, South Africa, Swaziland, the United Republic of Tanzania, Zambia and Zimbabwe.

I. A competitive and efficient fiscal regime

Although reforming the fiscal system is unlikely to generate much investment (domestic or foreign) in and of itself, providing a competitive, fair and efficient regime should be a crucial element of Rwanda's economic policy. A number of improvements and modifications could be introduced over the coming years as part of the strategy to turn Rwanda into a centre of excellence in soft infrastructure and governance. These improvements should make the general regime attractive and competitive, and turn the RRA into the best tax administrator in the region. The reforms would:

Make Rwanda's general fiscal regime the most competitive and well-administered in the region

A number of incremental improvements and modifications could be introduced over the next few years in order to make Rwanda's tax regime a model of excellence in administration, efficiency and fairness, and the most competitive in the region. The recent reduction in the corporate income tax rate is a step in the right direction, as is the decision to provide unilateral tax credits on foreign sourced income. Additional measures to make the *general* regime more competitive could be adopted:

- Lower the headline corporate income tax rate to 25 per cent in the near future and bring the dividend withholding tax rate to 10 per cent;
- Provide for faster rates of depreciation on durable assets and allow unlimited loss carry-forward in lieu of the current five years;
- Set up a comprehensive duty drawback scheme for exporters;
- Further improve capacity at the RRA, provide more clarity in tax regulations and ensure full consistency between the three language versions of the fiscal laws and regulations;
- Draw up clear guidelines and regulations for transfer pricing;
- Minimize the impact of taxation on companies' cash flow, including through removing anticipatory payments on corporate income tax and the 3 per cent tax on the value of invoice for winners of public tenders.

Streamline the administration of incentives

Incentives provided by law should be easy to administer and widely and readily available to investors. Small investors should not be discriminated against, which is currently the case as RIEPA certificates serve as the gateway to a number of incentives. This should no longer be the case and eligibility conditions to RIEPA certificates should be reformed (see below).

Make fiscal incentives outcome-based and targeted to development goals

Incentives should be conditional upon outcomes and available to all who reach the desired outcome, regardless of other conditions (size, time of establishment, etc.). These could focus on employment creation and export promotion (as is already the case), but could also target the transfer of knowledge and skills. The Government could consider:

- Supplementary deductions from the income tax base for personnel training expenses;
- Targeted incentives to attract foreign skills and entrepreneurship.

Minimize the impact of taxation on companies' cash flow

This would call for removing measures such as anticipatory payments on corporate income tax and the 3 per cent tax on the value of invoice for winners of public tenders.

2. Skills attraction and dissemination programme

The skills attraction and dissemination programme should be a central element of Rwanda's FDI strategy and its development policy. It should transform immigration policy from a *passive admission* of foreign skills to a *proactive skills attraction and dissemination attraction programme*. The programme (detailed in section D.4) should be articulated around five elements.

a. Identify skills and competences needs

The skills and competences needs must be clearly assessed. The assessment would underpin the implementation of the immigration policy and would be revised periodically as the economy and local skills develop. Given Rwanda's current situation in terms of human resources and the skills and entrepreneurship gap, and in order to kick-start the programme, a relatively wide range of skills should be included in the initial assessment. The skills need is not limited to competences requiring university or higher-education training.

b. Redesign immigration policy

Proactively attracting skills and competences will require an overhaul of immigration policy and regulations. The current system only allows the import of certain types of skills (university degree is required) and does nothing to actively attract investors and skills. Redesigning immigration policy should focus on two schemes: (1) a business talent scheme; and (2) an expatriate employee scheme.

Business talent scheme

Attracting business talent at the level and scale appropriate to Rwanda's economy requires an attractive set of measures for individuals to establish in the country as small- and medium-scale investors. A business talent scheme aimed at attracting entrepreneurial skills could be structured along the following lines:

- Create "investor permits" for skilled individuals investing in Rwanda, with minimum capital requirements used to prevent the illegitimate use of these permits;
- Provide permits for nuclear families. Individual investors need to be allowed to move to Rwanda with members of their nuclear families, who should also be permitted to work in the business;
- Provide certainty on permits. Individual investors need to have sufficient certainty that their permit will be renewed as long as the business is in operation. Clear guidelines and conditions as to how and under what conditions permanent residence status (or citizenship) can be gained should also be established;
- The investor permit should combine work and residence permits.

Promoting the integration of newcomers into Rwanda's social fabric would also call for language requirements. Investors may be required to be fluent in English, French or Kinyarwanda to obtain the permit, or at least make a firm commitment to learn one of the three languages, and be subject to a test after a number of years.

Expatriate employee scheme

The second aspect of redesigning immigration policy should make the process of importing skills and competences in short supply in Rwanda as smooth and efficient as possible, while at the same time maximizing the dissemination of skills and competences to nationals through well-targeted training requirements. The current “back-loaded” approach to allocating work and residence permits should be transformed into a “front-loaded” approach by implementing the following measures:

- Draw a list of skills that are in short supply at the national level. For these predetermined skills, the sponsor (employer) would not need to conduct individual labour-market test to prove that it cannot find a qualified national to fill the position;
- Lift the requirement that the expatriate worker hold a university degree. This condition does not provide an appropriate benchmark to evaluate Rwanda's skills needs;
- Screen sponsors based on their track-record of good-practice in employing expatriate workers (training programmes for nationals, no excessive recourse to expatriate workforce, no overstays, etc.). Sponsors with a good track-record would be subject to less extensive verification than sponsors without track-record or with a poor one;
- Unify work and residence permits;
- Lengthen the period of issuance of the single permit from one-year to up to three years.

c. Set up training and transfer of skills requirements

Concrete mechanisms to maximize the dissemination of skills, know-how and competence to Rwandan nationals should be established so as to help achieve one of the goals of Vision 2020. At the moment, employers are required to put in place an understudy programme for each expatriate employee. A wider dissemination of skills to nationals would be ensured with the following mechanism:

- Require entrepreneurs obtaining investors' permits to set up training schemes for national workers;
- Make training and localization a company-wide obligation in lieu of position-specific understudy programmes when expatriate workers are hired. Training obligations could be linked to the number of expatriate workers, turnover, or a combination of these and other factors.

d. Provide special incentives to individuals

In addition to *allowing* people to establish and set up businesses in Rwanda, the Government would need to put in place some measures to *entice* them to do so. Possible measures include:

- Duty-free import of personal belongings upon installation;
- Non-resident status for personal income tax purposes for a limited number of years;
- Special provisions for the transfer of funds abroad;
- Support services for installation (finding housing, schooling, medical care).

e. Actively promote Rwanda and target people

Once an appropriate policy and regulatory framework has been put in place, the Government will have to actively promote Rwanda as a destination not only for investment by corporations, but also for individuals to invest and reside in. This promotion and awareness effort would be best targeted at

individuals from within the region with some prior knowledge of Rwanda. It would in a sense be an extension of the efforts already in place to entice Rwandans from the Diaspora to return home and invest.

3. Centre of excellence in regulation and soft Infrastructure

Modern regulations and strong regulatory institutions will become more and more important as Rwanda evolves towards a private-sector driven and market-based economy, and as the private sector role in providing backbone services (telecommunications, electricity, water, transport) increases. Such regulations will be essential for three main purposes:

- Protect national and consumers' interest;
- Avoid the potentially negative consequences associated with investments (market dominance, anti-competitive behaviour, environmental damage, health issues, etc.) and ensure good practices (labour standards, corporate social responsibility, etc.);
- Provide the predictable, fair and attractive investment environment that is essential for the private sector to thrive.

The quality of regulations, oversight and Government services should serve as a key element of Rwanda's FDI strategy by turning the country into a centre of excellence in soft infrastructure and governance (chapter III, section D.3). Excellence in administration should be achieved, as a minimum, in the following areas:

- Fiscal administration;
- Customs administration;
- Immigration services;
- Land registration;
- Services to investors;
- Commercial justice;
- Environmental standards.

a. Next generation RIEPA certificates

RIEPA certificates should not serve as a gateway to fiscal incentives, which are best structured on an outcome basis. The discrimination against small investors in accessing facilitation services and other benefits should also be removed. Non-capital eligibility conditions to certificates, however, could be used to promote responsible corporate behaviour and compliance with Rwanda's laws. The following approach to RIEPA certificates is recommended:

- Lift the minimum capital requirement as an eligibility condition;
- Preserve a capital requirement to benefit from automatic access to three work permits;
- Lift the certificates' role as a condition to obtain fiscal incentives and eliminate RIEPA's administrative function for tax matters;
- Use general eligibility conditions for certificates to promote an "induction" programme. Registration with RIEPA would require that the company (shareholders and executives) complete an induction programme on Rwanda's key business laws, corporate compliance responsibilities (employment practices, tax compliance, observance of health and safety standards, environmental protection) and in business ethics.

b. Sectoral regulations and regulatory oversight

In addition to general public services, excellence should be achieved in a number of sectoral regulations, including:

- Telecommunications;
- Electricity and water;
- Transport;
- Mining;
- Banking;
- Agriculture.

Building up RURA's capacity should be considered as a matter of priority. Aside from providing it with the necessary resources and qualified staff, it will be particularly important to ensure that RURA's function is supported by modern laws and regulations. While this is the case for the telecommunications sector, laws remain to be adopted for the remaining five sectors⁵⁷ falling under RURA's mandate. Given the constraints that they currently represent for economic development, two sectors should be the focus of attention: (1) electricity; and (2) transport, in particular airline and airport services.

c. Competition framework for development

Rwanda currently has only a skeleton set of competition rules and regulations and no competition authority. Yet, the small size and limited industrial and tertiary development of Rwanda's economy make it more likely that existing or new companies be in *de facto* monopolistic situation or enjoy dominant market power. Under such circumstances, it is important that Rwanda start equipping itself with the tools to efficiently monitor, supervise and if necessary influence the price setting and market behaviour of dominant firms.

This would require drafting a new competition legislation in order to, at a minimum:

- Precisely define market dominance and anti-competitive behaviour;
- Provide a regulatory framework for mergers and acquisitions;
- Elaborate monitoring and enforcement mechanisms;
- Define monitoring and regulatory powers on the pricing of goods and services in market segments dominated by one or a reduced number of companies;
- Coordinate the work of the competition authority with RURA.

⁵⁷ Electricity, water, waste management, gas extraction and distribution and transport.

III. FDI STRATEGY

A. Introduction

Rwanda faces tremendous development challenges. The lack of transformation of the economy over the past decades implies that most of the population derives its income or subsistence from agriculture. At the same time, the rising population, land pressure, erosion and mode of exploitation imply that labour productivity in agriculture has been on a declining trend. In order to engage on a sustainable development path,⁵⁸ achieve a broad-based reduction in poverty and the Millennium Development Goals (MDGs) and entrench peace and stability, Rwanda will need to transform its economy by developing the secondary and tertiary sectors. This is clearly recognized in the Vision 2020 development strategy.

The transformation towards an industry- and services-based economy is the only way for Rwanda to create the vast number of jobs required by a very young population (chapter I, section A.4). Based on the 2002 census, about 220 000 young men and women will enter the workforce every year in 2006-2010, rising to about 265 000 annually in 2016-2020.⁵⁹ This compares to a *total* of only 200 000 off-farm jobs in the formal sector in 2000. If Rwanda is to achieve the objectives of Vision 2020 and the MDGs under the envisaged timeframe, it will have to generate a process of transformation on the scale and speed of those experienced by successful Asian economies in previous decades.

While national investment (private and public) will undoubtedly have to lead that process of transformation, FDI could contribute significant benefits. Foremost among those are the contribution and transfer of skills, know-how, entrepreneurship and capital. Given the structure of Rwanda's economy and the constraints to investment, the Government should put in place a somewhat unconventional FDI strategy, geared towards the attraction of individual entrepreneurs and small- and medium-scale companies across a very wide range of sectors. This chapter proposes such a strategy and defines the role that FDI can realistically be expected to play in Rwanda's development.

B. FDI in the national development goals

Vision 2020, the Poverty Reduction Strategy Paper (PRSP) and the National Investment Strategy all recognize that the commercial private sector will have to lead the process of economic development and wealth creation. The public sector's role is to be focused on providing an enabling legal and regulatory framework, basic infrastructure and social services – most importantly health and education (chapter I, box I.2). Energetic government action in these areas was initiated several years back, and public sector investment in infrastructure still plays a leading role. Crucial public sector measures in the coming years include further investment in the power sector, transport, education and health. It is expected that private investment will then blossom, including in infrastructure services such as telecommunication and power generation.

Government policy papers do not provide any detailed analysis of the role FDI is expected to play in private sector development, nor do they propose a comprehensive strategy as to how it can be promoted. The need to attract FDI and its role are nevertheless recognised in several instances, including

⁵⁸ Both in terms of achieving high growth rates over a sustained period of time, and in terms of socially and environmentally sustainable development.

⁵⁹ Based on the age cohorts of the 2002 population census, and assuming an age of 18 as the "entry point" into the workforce.

by stating that attractive policy measures will have to be put in place, and that “Rwanda needs to market itself aggressively as a location for investment”,⁶⁰ or that “the country will (...) increase the flow of private capital, particularly direct foreign investment”.⁶¹ As evidenced in chapter II, Rwanda has an open regime to FDI and the Government expects it to make a significant contribution to the projected requirements for private investment (box III.1).

Box III.1 The role of FDI in Rwanda’s development and investment strategies

Vision 2020

Vision 2020 targets an average real GDP growth rate of 8 per cent throughout the period, in order to raise GDP per capita from about \$200 currently to \$900 by 2020. Such growth rates would require, according to the strategy, gross investment rates of 23 per cent by 2010 and 30 per cent by 2020. Such rates of investment would underpin average growth rates in industry and services of 9 per cent and 12 per cent by the same dates. Vision 2020 suggests that finance, tourism and ICT will be key growth areas.

Vision 2020 frankly acknowledges the weaknesses that Rwanda will have to overcome (box I.2) and places the development of a thriving national business culture (with a reduced role for the public sector in commercial activity) at the centre of the economic strategy. FDI is mentioned explicitly a number of times, but always in relatively general terms (e.g. the need to establish an attractive regime for investment, role of Diaspora in mobilizing FDI, need for the Government to promote FDI), and without providing quantified estimates as to how much could be attracted, in what sectors and how.

National Investment Strategy

Vision 2020 is complemented by a more detailed National Investment Strategy (NIS) for the period to 2010. The strategy foresees a period of rapid public investment in infrastructure and agriculture and comprehensive legal and administrative reform until 2006, in order to provide the basis for faster private sector development. Thereafter, infrastructure rehabilitation is consolidated and private investment is expected to “assert itself” in industry and services. Apart from this broad strategic outlook, the NIS is effectively a document on the planning, implementation and funding of public investment rather than a blueprint for the stimulation of private investment.

RIEPA’s strategic action plan (2005-2007) estimates that private investment in the near future would have to account for 40 per cent of the targeted investment rates of around 22 per cent of GDP, converging towards 30 per cent of GDP by 2020. It calculates that the NIS plan would require FDI to account for 70 per cent of private investment (equivalent to about \$125 million in 2005), which it deems unrealistic. Such expectations do indeed appear excessive, particularly given that net FDI inflows in 2004 were \$11 million. They are also unrealistic in regard with the experience of other countries with respect to the attraction of FDI relative to their own level of national investment, as is elaborated upon below.

Sources: Vision 2020, National Investment Strategy and RIEPA Strategic Action Plan (2005-2007).

⁶⁰ Poverty Reduction Strategy Paper, p. 65.

⁶¹ Vision 2020, p.39.

The need for a well-defined and realistic assessment of the potential contribution of FDI still remains. Beyond general expectations and considerations, and some more detailed sectoral policies, Rwanda lacks a strategy that:

- Has a clear conception of the prospects, including limitations therein, for attracting FDI;
- Utilizes FDI to help overcome development constraints by contributing capital, entrepreneurship, skills, know-how and technology.

It is difficult to forecast accurately the level of FDI a country is likely to attract, particularly when major reforms are being implemented in the investment framework and the economy is expected to undergo significant transformation, as is the case in Rwanda. The experience of other economies over the past decades offers some guidance as to what Rwanda can expect, however. While a few countries have experienced exceptionally high FDI inflows per capita for a sustained period of time, these are very particular cases that Rwanda cannot hope to replicate.⁶²

The relative level of FDI inflows (FDI per capita) is strongly correlated with the relative level of *national* investment (total investment excluding FDI, as a percentage of GDP). Over the past decades, the countries that have succeeded best in attracting foreign investors were – in general terms – those that also recorded high levels of *national* investment. This correlation is strong, regardless of whether one considers all developing countries together, or whether one looks at it from a regional perspective (figure III.1). It holds not only for sub-Saharan countries with relatively modest FDI inflows, but also among fast-growing east Asian countries with high FDI inflows.

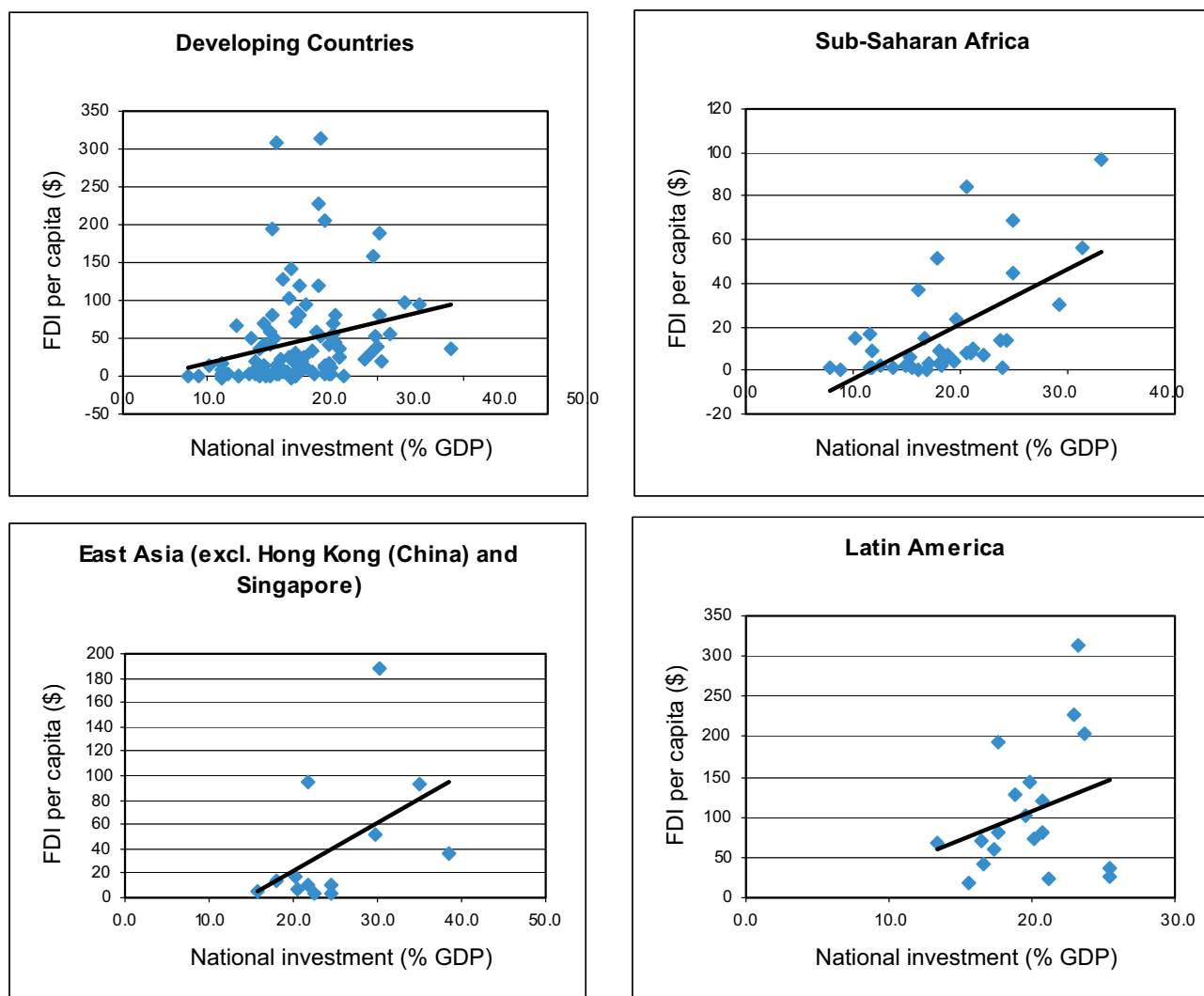
This correlation indicates that foreign investors are more attracted by economies where local investment itself is dynamic, and that FDI *complements* national investment more than substituting for it or competing with it. While FDI brings specific benefits to an economy, it is illusory for any country to expect it to substitute for a lack of national investment.⁶³ The vast majority of foreign investors do not operate in enclaves. To the contrary, they seek and benefit from a dynamic local private sector, and are dependent upon the availability of skills, infrastructure and networks of suppliers, all of which are determined mostly by the level of national investment (public and private).

Rwanda should thus form realistic expectations about the level of FDI and its impact on the economy, and be conscious that national investment will be the main driving force behind its economic transformation. Dynamism among national investors will be a key determinant of Rwanda's attractiveness to foreign investors, and both types of investments are likely to reinforce each other. Given the current low level of relative inflows of FDI as compared to other countries in similar situations, Rwanda can hope to attract much higher FDI inflows in the near future. Attracting as much FDI per capita as other LDCs have over the past decade would imply a ten-fold increase over what Rwanda has attracted on average during 1994-2004. The same order of magnitude would apply if one considers other relative measures of FDI inflows (table III.1), and would be even larger if Rwanda were to achieve the same relative performance as developing countries as a whole.

⁶² These countries include Hong Kong (China), Singapore, fiscal havens and a few countries with large natural resources and a small population.

⁶³ Even though there may be a few notable exceptions, typically driven by the exploitation of natural resources.

Figure III.1. FDI per capita and national investment as a percentage of GDP
(1994-2004, period average)



Source: UNCTAD, FDI/TNC database.

Table III.1. Indicators of relative FDI inflows, 1994-2004 average

	Rwanda	Developing countries	Sub-Saharan Africa	LDCs	East Asia
FDI per capita (dollars)	0.6	38.2	13.1	7.5	52.5
FDI per \$1000 GDP	2.7	28.2	24.2	22.8	36.3
FDI (% GFCF)	1.5	10.9	14.5	12.8	10.8
National investment (% GDP) ¹	16.9	24.5	13.6	14.2	30.2

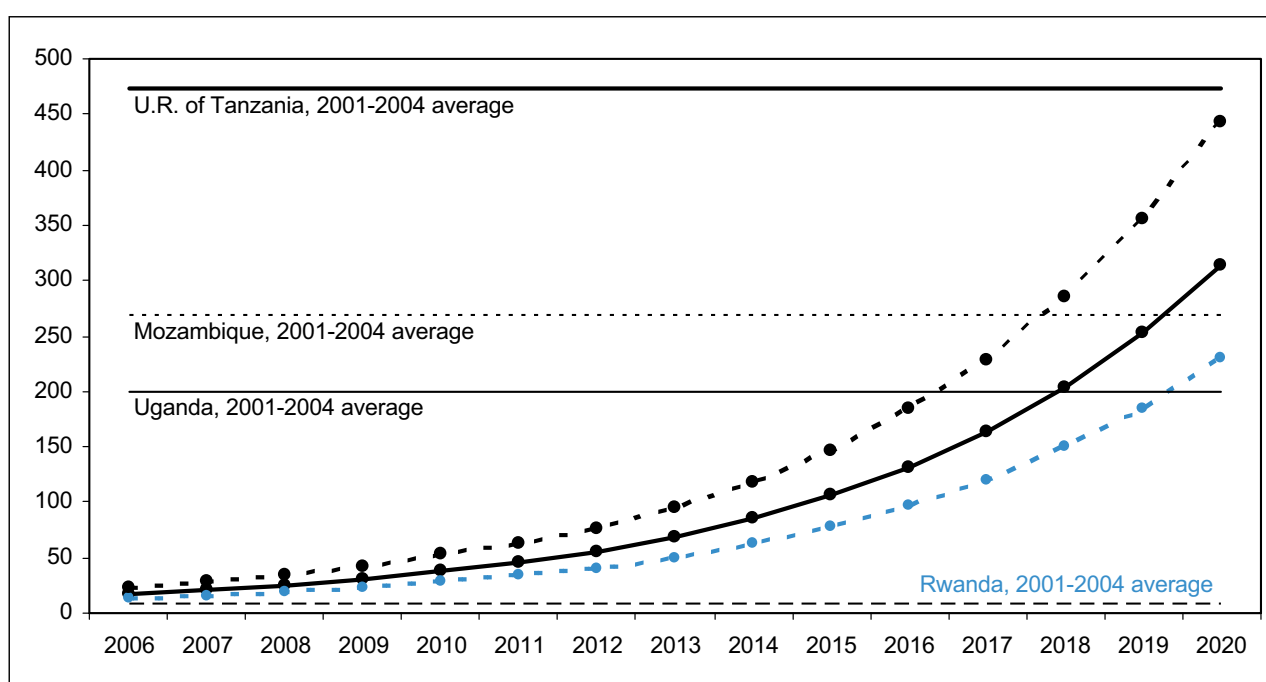
¹ Domestic investment, excluding FDI.

Source: UNCTAD, FDI/TNC database.

Such comparisons can only offer rough indications of what can realistically be expected. They provide a reasonable medium-term benchmark, however. If Rwanda were to attract as much FDI per capita as sub-Saharan Africa did over 1994-2004, this would translate into annual inflows of about \$130 million over the next decade. Yet, it is probably more appropriate to assess how much FDI Rwanda could attract based on prospects for GDP growth and national investment rates, and on potential shifts from past trends resulting from policy actions.

Over the past decade, FDI inflows to Rwanda amounted to about 1.5 per cent of gross fixed capital formation (GFCF), with national investment amounting to about 17 per cent of GDP. Sustained reforms could generate nominal dollar GDP growth of 10 per cent⁶⁴ over the next decades and raise national investment rates from 20 per cent of GDP in 2005 to 30 per cent by 2020. Under such a scenario, the implementation of an FDI strategy as proposed in this chapter could aim to raise FDI inflows as a percentage of GFCF from 3 per cent in 2004 to 10 per cent by 2020. Net FDI inflows could thus rise from about \$20 million in 2006 to \$300 million by 2020 (figure III.2). A “high-end” scenario of whereby Rwanda would attract FDI inflows equivalent to 14 per cent of GFCF would generate FDI inflows of about \$450 million by 2020.⁶⁵ These numbers should by no means be taken as forecasts or targets, but they set a general framework for ambitious yet realistic goals regarding FDI inflows.

Figure III.2. Potential net FDI inflows, 2006-2020 and comparator LDC countries
(Millions of dollars)



Source: UNCTAD estimate.

This level of inflows would generate major developmental benefits to the economy and help achieve the goals set in Vision 2020. In particular, foreign investment would likely contribute to: (1) human resources development and the transfer of skills; (2) the creation of a knowledge-based economy; (3) the

⁶⁴ Assuming real GDP growth of 8 per cent along the lines of Vision 2020.

⁶⁵ With other assumptions unchanged.

development of entrepreneurship and a competitive private sector; (4) a wider economic base; and (5) better infrastructure.

C. Conceptualizing an FDI strategy for Rwanda

Broad expectations/targets for FDI inflows were determined above. Such inflows are unlikely to materialize without a specific FDI strategy, however. While such a strategy does not exist at the moment, this chapter suggests an approach to fill this gap. The proposed approach has implications for policy, investment promotion and targeting, and the priorities of government agencies that lead the attraction and facilitation of investment, such as RIEPA. A number of factors and constraints first need to be clearly identified and understood in order to conceptualize an implementable and effective FDI strategy.

Factor I: investment constraints for the long term

Rwanda faces a number of constraints to investment, both local and foreign, that will not fundamentally change over the medium term (15 years to the end of Vision 2020) and should be taken as given:

a. International land transport

There will be no fundamental easing of Rwanda's severe international land transport constraints resulting from its landlocked nature. Transformational improvements in land transport to seaports in Kenya and the United Republic of Tanzania are not to be counted on before the 2020 horizon. There could be some easing in the soft constraints arising from transport and port inefficiencies at an earlier stage, but this is the most that can be expected.

Road access to ports is either via the northern corridor through Uganda to the Kenyan port of Mombasa, or via the central corridor through the United Republic of Tanzania to the port of Dar-es-Salaam. At the moment, about 60 per cent of Rwanda's sea freight is handled via Mombasa. Transport through both corridors suffers from poorly maintained roads, pilferage, port inefficiencies and Customs clearance delays.

The closest potential rail link from Kigali to sea is to Dar-es-Salaam via Isaka in the United Republic of Tanzania, for a total distance of about 1400 kilometres. Although a rail link already exists between Isaka and Dar-es-Salaam, it is estimated that the cost of connecting Kigali to Isaka and of rehabilitating the existing rail infrastructure would be as high as \$2.4 billion. The African Development Fund⁶⁶ is helping the Rwandan and Tanzanian governments finance a feasibility study on the project, which will consist of a detailed assessment of the engineering and cost requirements of the project, as well as the possible involvement of the private sector in financing and/or operating the railway under different forms of concessions.

The railroad would serve a wider regional objective and facilitate access to sea for Burundi, the eastern part of the Democratic Republic of the Congo and parts of Uganda. If carried out, it would also help Rwanda position itself as a transport hub in the subregion. The economic feasibility of the railway remains to be assessed, however, and the commercial viability for private sector involvement seems doubtful at this stage. Assuming that *all* merchandise exports and imports from Burundi and Rwanda, and a quarter of merchandise exports and imports from the Democratic Republic of the Congo, had been

⁶⁶ The concessional lending arm of the African Development Bank.

transported on this new railroad,⁶⁷ the value of merchandise carried through would only have amounted to \$1.5 billion in 2004. Even under relatively optimistic assumptions that exports and imports would grow around 10 per cent a year through 2020 and that freight charges amounted to 10 per cent of the value of the merchandise, revenue for the railway would only grow from \$150 million in 2004 to \$690 million in 2020.

Rwanda has indicated its intention to further negotiate preferential access to international markets (both regionally and globally) in order to enhance the potential market for its exporters. Land transport constraints, which affect manufacturing companies in terms of cost and time-sensitivity for both imported inputs and exports, are nevertheless such that Rwanda will not, in the medium term at least, be in a position to attract TNCs seeking least-cost production centres for *globally* traded goods operating on thin margins. This would not rule out other types of foreign investments in manufactured goods if other competitiveness constraints are lifted, however. These could include low-weight, high-value goods or manufactured goods produced and traded at the regional level.

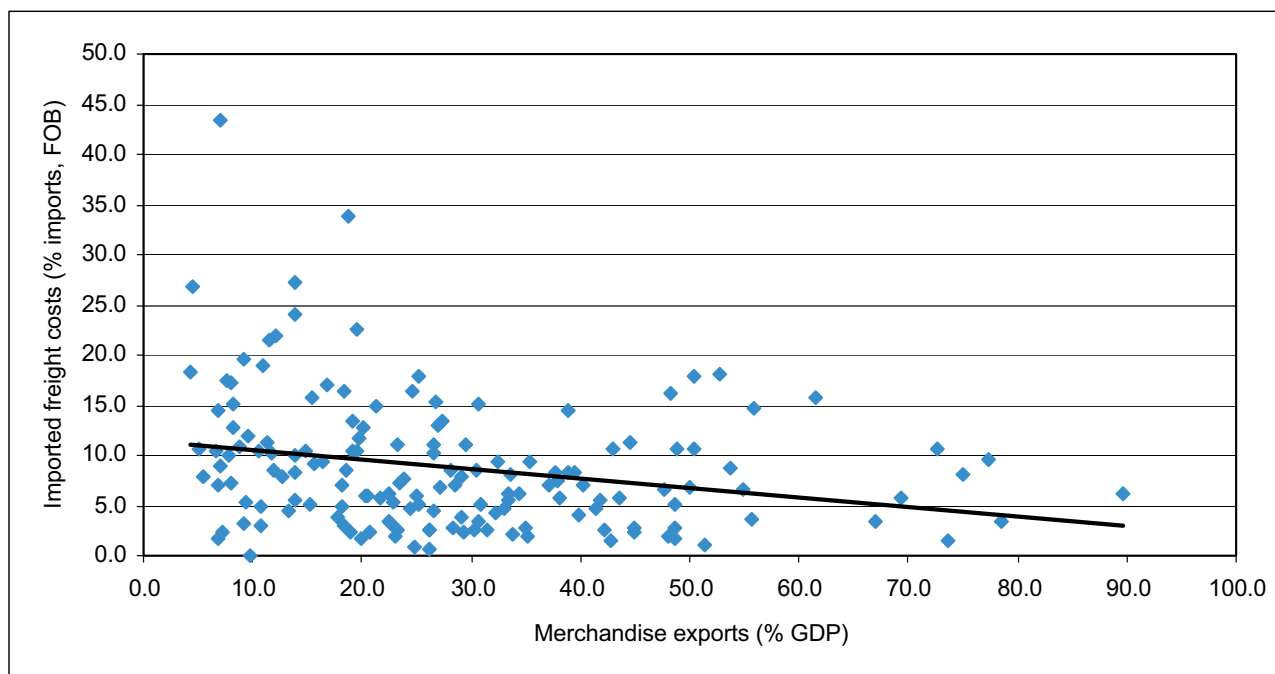
The competitiveness consequences of high transport costs for exporters based in Rwanda can be assessed by considering the value of imported freight costs relative to the FOB value of merchandise imports. Rwanda had the 11th highest ratio among 157 countries,⁶⁸ with imported freight costs representing 18.4 per cent of the value of imports. In contrast, Kenya had a ratio of 9.2 per cent, the United Republic of Tanzania 11.9 per cent, and most of the big Asian exporters had ratios around 5 per cent (see also table I.4).

Such ratios imply that producers located in low transport cost countries enjoy a significant competitive edge over countries like Rwanda, which can amount to more than 10 per cent of the value of the good. When the cost of imported inputs and other advantages such as timeliness of delivery are factored in the transport constraints in Rwanda and other landlocked countries can easily outweigh any competitive edge that may be gained under preferential trade arrangements, such as the United States' African Growth Opportunity Act (AGOA) or the European Union's Everything but Arms (EBA) initiative. The implications of such transport handicaps clearly show in that countries with high imported freight costs to imports ratios tend to have lower exports to GDP ratios (figure III.3).

⁶⁷ That is, ruling out all road and air transport for merchandises as well as excluding any transport via the northern corridor.

⁶⁸ Based on 1994-2004 average data.

Figure III.3. Imported freight costs (percentage of imports, FOB) and merchandise exports (Percentage of GDP), 1994-2004 average



Source: UNCTAD, based on IMF, *Balance of Payments Statistics and World Economic Outlook*.

b. Market size and economic structure

Regardless of the actual growth performance during the period of Vision 2020, Rwanda will remain a very small market for global TNCs. As of 2004, Rwanda ranked as the 149th economy in the world,⁶⁹ with nominal GDP of \$1.8 billion, equivalent to 0.004 per cent of world output. Even under the assumption that nominal dollar GDP grows at around 10 per cent per annum through 2020, it would still amount to less than \$9 billion. Such a size would only rank Rwanda at the 103rd place in the 2004 ranking, behind countries as Ghana, Botswana, the United Republic of Tanzania, Cameroon, Kenya, the Dominican Republic or Costa Rica.⁷⁰

Evidently, steps to enhance regional integration and market access can increase the “reach” available to an investor located in Rwanda. In such cases, the transport constraints highlighted above will remain a handicap, however, and Rwanda would have to compete with neighbouring countries in attracting regional-market seeking foreign investors. The small market size will thus restrict Rwanda’s FDI attraction potential in a number of – though by no means all – business sectors in goods and services. The small market size constraint will in particular limit Rwanda’s attractiveness for large TNCs, including in utilities and other services sectors. This may also generate potential issues in attracting “quality” investors, i.e. firms that have established a leadership in their area of operation.

In addition to its small size, Rwanda’s economy is mostly rural. While the core objective of development policy for the decades to come will be to transform Rwanda into an industry- and services-led economy, the process of transformation will take decades. Within the 2020 horizon, the primary sector will remain

⁶⁹ Measured by nominal dollar GDP, out of 180 countries for which data were available.

⁷⁰ Based on data from the World Economic Outlook, IMF.

predominant in terms of output and employment, regardless of the success achieved in promoting industry and the services sector. The small size and shallowness of the secondary and tertiary sectors will thus remain a constraint for foreign investors requiring strong networks of suppliers and services providers.

Factor 2: the world is a village, but Rwanda's export potential is mostly regional

The combination of international transport constraints, high operating costs, low skills base, small market size and underdeveloped manufacturing and services sectors means that Rwanda's aim in the foreseeable future should be to transform itself into a small but efficient player in the regional market. In spite of the technological and policy changes that have globalized trade flows, and in spite of the preferential market access that it enjoys in the United States and the European Union, Rwanda should recognize the following limitations:

- Attracting FDI in globalized and highly competitive manufactured goods, which have become increasingly "commoditized", is out of the question for the period under Vision 2020. The efficient production of these goods requires world-class infrastructure at internationally competitive costs, which Rwanda will not be able to provide for some time. They also tend to be highly time-sensitive in terms of delivery, and require well-developed domestic supply chains;
- Attracting FDI for the production of high-technology, high value-added goods is mostly ruled out by the low skills base and absence of a dense network of local suppliers or technology clusters;
- There will be a number of opportunities to attract FDI in niche export sectors with a global orientation, such as tea, coffee, horticulture, mining and others.

The limitations that prevent Rwanda from attracting large foreign investors seeking production centres for the global market also represent a handicap in the attraction of smaller regionally-oriented investors. They are less significant, however, and can be addressed with appropriate policies. In particular, the underdeveloped industrial and services sectors – and the predominance of imports in these sectors – and a fair degree of natural protection against imports imply that small- and medium-sized investors may see opportunities to supply the local market from a domestic production base. The “indigenization of imports” could constitute a platform towards exporting to the subregion at a later stage.

Although achieving a position of efficient player (in industry and services) in the regional market may seem a modest ambition, much remains to be done to attain such a goal. Rwanda currently lags well behind regional leaders, including Kenya and Uganda, in particular in terms of commercial skills and capacities. In addition, the combined GDP of Burundi, the Democratic Republic of the Congo, Kenya, Uganda and the United Republic of Tanzania was \$41 billion in 2004, 23 times that of Rwanda, and it has been growing at around 6 per cent per annum over the past 4 years. The regional market is thus far from negligible given Rwanda's own scale.

Factor 3: fundamentals for manufacturing and services must attain at least regional standards

Rwanda's ability to avail of export opportunities in the regional market and position itself as a competitive and attractive location for regionally-minded foreign investors will require improvements in a number of key areas that determine investment location. Rwanda will have to attain at least regional standards, or be “best in the region” in the following areas:

- Regional market access (trade agreements);
- Land transport;
- Utilities (electricity and water);
- ICT infrastructure;
- Business and labour skills and human capital;
- Legal and regulatory framework of investment (including investment facilitation and governance);
- Quality of life and personal safety.

Table III.2. Regional competitiveness benchmarks, 2005

	Rwanda	Kenya	South Africa	Uganda	United Republic of Tanzania
COMESA membership	Yes	Yes	No	Yes	No
COMESA-II	Yes	Yes	No	No	No
EAC membership	Applied	Yes	No	Yes	Yes
SADC membership	Applied	No	Yes	No	Yes
Paved roads (km/1000 km ²)	4.0	1.4	4.7	0.9	0.4
Electricity cost (business use, \$/kwh)	0.198	0.083	0.0274	0.14	0.0585
Mobile communication cost (mobile to regional number, \$/min)	0.44	0.63	0.47	0.49	0.37
Adult literacy rate (per cent)	64.0	73.6	82.4	68.9	69.4
Secondary school gross enrolment ratio	16.1	32.9	87.7	19.7	5.8
Transparency International, CPI ¹	3.1	2.1	4.5	2.5	2.9
<i>Doing Business</i> indicators: ²					
Procedures for licences (number)	17	11	18	26	19
Difficulty of hiring index ³	56	33	56	67	0
Cost of registering property (per cent of value)	9.6	4.1	11.0	12.2	5.1
Time for exports (days)	63	45	31	30	58
Time for imports (days)	92	62	34	51	73
Cost of enforcing contracts (per cent of debt)	43.2	41.3	11.5	35.3	22.3

¹ Corruption Perceptions Index (rated from 1 to 10, with 10 indicating least corruption).

² World Bank (2005). *Doing Business*.

³ Higher index denotes higher difficulty, with maximum of 100.

Sources: CIA World Factbook, Transparency International, UNCTAD, UNESCO, World Bank, and various national sources.

The most advanced competitor in manufacturing and services in the region is doubtlessly Kenya, and South African firms are increasingly penetrating the East African market. Rwanda should consistently benchmark itself against Kenya where it is a leader, and aim for South African standards in the medium term. At the moment, Rwanda lags behind regional leaders in many indicators that determine enterprise competitiveness and investment location decisions (table III.2). The weakness is particularly strong in terms of cost, availability and reliability of electric power, transport cost, availability of local suppliers and in human resources. In contrast, Rwanda compares favourably in the region in terms of corruption and commitment and speed of reforms.

Regional market access

Rwanda is currently member of COMESA, as well as its subset of 11 countries that have constituted a free-trade area.⁷¹ It has also applied for membership of the EAC⁷² and SADC.⁷³ While joining SADC may take some time, there are indications that Rwanda could join the EAC within about a year, together with Burundi.

Hard infrastructure

The Government is developing indicators of internal road access that will enable it to benchmark Rwanda against regional countries. Trunk road network coverage and quality are good for an LDC and compare well with neighbouring countries. Rwanda has about 4 kilometres of paved road per 1000 square kilometre of land, which is almost as much as South Africa, and more than all other neighbouring countries. Trunk roads are also in good general condition and well maintained. Feeder roads are in a poorer condition, however, and many parts of the country remain a long distance away from trunk roads.

Most international air connections are operated from Kigali's Kayibanda International Airport, with Kamembe Airport near Cyangugu also equipped to handle international traffic. Scheduled international passenger services to Kayibanda airport are provided to Addis Ababa, Bujumbura, Entebbe, Johannesburg and Nairobi. There is only one transcontinental scheduled flight, operated twice-weekly by SN Brussels Airlines to Belgium.

Kayibanda Airport has adequate capacity for near-term needs, although there are operational restrictions, particularly for cargo-handling. The absence of a taxiway parallel to the runway also limits the traffic that the airport can handle, and can generate potential safety issues in case emergency landings are required. There is space to build a taxiway, however, and it has been estimated that Kayibanda Airport should have enough capacity, pending some additional investment, for the next 25-30 years. The Government has nevertheless initiated a feasibility study to build a new airport some 40 kilometres outside Kigali. The study should clarify the need for this new facility.

Air cargo facilities (warehousing and handling) are basic, but have recently been expanded and improved, including the construction of additional warehouse for exports and the installation of basic cold storage equipment. There are three all-cargo carriers operating on a scheduled basis, in addition to

⁷¹ COMESA members are Angola, Comoros, the Democratic Republic of the Congo, Eritrea, Ethiopia, Namibia, Seychelles, Swaziland and Uganda, together with Burundi, Djibouti, Egypt, Kenya, Madagascar, Malawi, Mauritius, Rwanda, Sudan, Zambia and Zimbabwe, which constitute the COMESA-11 subset.

⁷² The EAC, which includes Kenya, Uganda and the United Republic of Tanzania, turned into a Customs Union in January 2005.

⁷³ SADC members are: Angola, Botswana, Democratic Republic of the Congo, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, South Africa, Swaziland, United Republic of Tanzania, Zambia, Zimbabwe.

cargo carried by passenger flights. Perishable exports such as flowers are currently transhipped through Nairobi on scheduled flights by Kenya Airways and Rwandair Express.

In the area of telecommunications, Rwanda has benefited from a boom in mobile telecommunications. MTN-Rwandacell is currently the sole mobile operator in Rwanda, but the cost of mobile telecommunications is competitive relative to neighbouring countries with competing operators (table III.2, table II.7). Terracom, which obtained a mobile licence as part of its purchase of Rwandatel in 2005, will soon provide mobile services. It has also laid out fibre optic cables in Kigali and other main urban centres.

Rwanda's foremost hard infrastructure weakness concerns the availability and cost of electricity. Electricity and water services are supplied by Electrogaz, a parastatal run under a 5-year management contract by Lahmeyer of Germany, which is partly owned by the giant utility RWE. There has been no meaningful investment since the 1980s to increase capacity in either system, and there has been a substantial shortfall in asset maintenance. The 1994 genocide disrupted expansion in power generation capacity, not least because Electrogaz depended on donors for long-term financing, and donor funding was withdrawn. Given the long lead times in power supply investments, the genocide disrupted many years of investment planning.

Electricity is less reliable and more expensive than in EAC countries, even though Uganda is also facing a power crisis (table III.2). Only 43MW capacity is installed.⁷⁴ Available supply is only about 50 percent of estimated peak demand, and there is frequent load shedding. New investors requiring significant amounts of power will not be connected unless they install their own stand-by generators. A flat tariff of ¢19.8/kwh is currently charged to all customers throughout the country, including industrial users. This is a cost recovery tariff only.

Improvements are underway, but there will be a critical power shortage until at least 2007. Lahmeyer is improving billing systems and metering. All 40 000 Kigali power customers are now on pre-pay meters. This includes Government ministries, which in some other countries are often delinquent payers. The Government recently entered into a joint-venture with Dane Associates to produce electricity from methane gas in lake Kivu. The generation plant will have a capacity of 39MW and is expected to be fully operational by late 2007.

Factor 4: soft infrastructure constraints are a challenge and an opportunity

Hard infrastructure constraints constitute a challenge that Rwanda will have to address as part of its overall development policy and FDI strategy. Soft infrastructure constraints, in turn, represent significant challenges as well as opportunities for Rwanda to position itself as an attractive investment location in the region. They can be divided into two categories of a different nature:

- *Human capital.* Rwanda lags far behind regional leader Kenya, and even more so South Africa, in terms of availability, depth and quality of skilled labour and entrepreneurs. Although the Government has made significant efforts in education and training, Rwanda will continue to lag at least Kenya in education and skills indicators through 2020, given the time it takes to acquire skills and spread higher levels of education widely across the population.

⁷⁴ Almost all of which is hydro-power, including Muzizi, a shared scheme with Burundi and the Democratic Republic of the Congo.

- *Operational environment.* Rwanda has made major progress in improving the legal and regulatory environment for investment over the past decade (chapter II). In many respects, it is catching up or achieving regional standards of best practices. Much remains to be done, however, and Rwanda should aim to differentiate itself from its neighbours by achieving global standards of best practices in a number of “soft” legal and regulatory factors that determine an enabling and attractive investment climate. Such factors include the administrative burden imposed on investors, the responsiveness, efficiency and speed of the administration (tax administration, licensing authorities, Customs, ...), the quality of regulations and regulators, governance, etc. Extremely ambitious goals can be set in these areas, with benchmarks and best practices countries extending far beyond the subregion. Aiming for and attaining such benchmarks is possible as far as soft infrastructure is concerned, which would mostly not be the case for hard infrastructure, where achieving regional standard is more realistic. Rwanda’s differentiation and attractiveness should thus hinge upon the quality of its soft infrastructure.

Factor 5: care for the quality of investors and investment

In the near future, Rwanda is likely to attract a number of little-known foreign investors whose track-record in their home country may be uncertain or difficult to ascertain. Only a small number of foreign investors in Rwanda are likely to be global industry-leaders. Rwanda has rightly adopted an open regime to all investors, subject to their complying with the laws of the land. This openness does not imply that the FDI strategy should not be concerned about the quality of investors and of investment.

While screening investors is to be ruled out, Rwanda will have to pay particular attention to the selection of investors in highly regulated industries where investment is subject to operating licences, sometimes through competitive bidding. This will be the case in particular for telecommunications, electricity, perhaps transport, and all investments taking place through the privatization programme. Under such circumstances, the FDI strategy will have to guarantee due diligence in ensuring that the selected investors have the required technical and financial ability, and that contractual obligations are well defined.

Where investors are not screened through a competitive bidding process or filing for limited licences, the Government will be able to ensure that quality investors are attracted and that positive impacts from FDI dominate by putting in place an appropriate regulatory framework and enforcing it. Investment incentives should also be outcome-driven, and carefully designed so as to support selected development objectives.

Factor 6: the genocide and recent history create special challenges

The pre-1994 economic structure, the genocide, the handling of refugees and the instability in the Great Lakes region over the past decade create special challenges for the FDI strategy. As seen in chapter I, the genocide set output back to its level of 1970. Even though the economy recovered to its 1990 level by 2000, the past decade of strong growth has effectively resulted been a “catching up” process.

Yet, the most severe consequences of the genocide for the FDI strategy are to be found elsewhere, in particular in:

- The impact on human capital, including as a result of the direct loss of lives and the disruption of the education system. The latter was totally disrupted as a consequence of a number of factors, including the vast movements of population in and out of exile, the death of a large number of teachers, the destruction of equipment and facilities, and problems in school administration;
- The disruption in public administration. The transition from one Government to the other was obviously not planned, a large number of documents were destroyed or lost, and projects had to be started anew.⁷⁵ The civil service had to be reconstituted as well, even though a number of civil servants remained in place and contributed some “institutional memory”;
- The impact on Rwanda's image in the world. Although the genocide was poorly covered by the world media with an almost complete absence of international reporters, it shattered Rwanda's image globally. The subsequent instability in the Great Lakes region added insult to injury. The current situation of peace, stability and personal safety has prevailed for a number of years now, yet Rwanda's image across the world remains that of the "genocide country".

The FDI strategy needs to bear these constraints in mind, and should seek to:

- Integrate itself into the Vision 2020 development policy framework;
- Diversify and strengthen the economic base (employment and wealth creation);
- Strengthen human capital;
- Strengthen public administration and infrastructure;
- Contribute to entrenching peace and stability, including through an even regional development and employment creation;
- Improve Rwanda's image across the world.

D. Cross-cutting elements of the FDI strategy

Rwanda does not currently have a sector or set of sectors that could be considered as the ideal candidates to generate strong growth and act as a magnet for FDI. What the economy requires is an across-the-board transformation, through the emergence of stronger and more diversified secondary and tertiary sectors. The FDI strategy should be similarly broad-based for three main reasons: (1) no single sector has by itself the potential to sustain the development of the economy and attract large FDI inflows; (2) FDI is needed to complement national investments in all sectors of the economy; and (3) skills, competences and entrepreneurship that can be brought by FDI is needed across the board.

Rwanda's FDI strategy should thus have an important “horizontal” component focusing on making the country as a whole more attractive as an investment location. This horizontal strategy should be complemented by a number of “vertical” policy packages aimed at addressing sector-specific investment and development issues. This section summarizes general policy measures that could be implemented to promote business development in Rwanda and attract FDI. Section E suggests policy packages for implementation in a number of broadly defined sectors.

⁷⁵ Projects with a long lead time were particularly affected. This includes all infrastructure programmes (transport, utilities, schools, health centres, ...), whether they involved construction or maintenance.

1. Beneficiation and market forces

The Government has made the increase of local value-added one of the main elements of its development policy. In particular, it hopes to increase value-addition in agriculture (tea, coffee and others) and in mining. As a general principle, however, the Government should seek to *remove barriers* to beneficiation, rather than *erect barriers* to enforce it. The latter approach is unlikely to succeed with national investors, and would certainly discourage foreign investment. It could also encourage rent seeking and generate lower returns to producers of primary commodities, if they are forced to sell to monopsonistic local buyers/processors. The Government strategy should thus aim at creating operating conditions such that beneficiation makes market sense, including potentially through fiscal incentives.

2. Skills attraction and dissemination programme and business mentoring scheme

The skills attraction and dissemination programme should be a centrepiece not only of Rwanda's FDI strategy, but also of its national development policy. Although such programmes are surprisingly most common among developed countries and rare in Africa,⁷⁶ Rwanda could tremendously benefit from setting one up. It would be a channel to attract the type of FDI that would contribute most to achieving national development goals, as it can be precisely targeted to attract the types of skills and competences that Rwanda needs most. The details of the programme are provided in Chapter II, sections D.4 and E.2.

In addition to this programme, Rwanda could develop a business mentoring scheme. The scheme would combine the features of retired executives programmes (see below) usually applied to strengthen public institutions and those of "business angels" programmes. The main purpose of the scheme would be to bring together: (1) development-minded retired business executives who are willing to put some seed capital into a Rwandan company and to contribute their expertise on a part-time basis; and (2) promising Rwandan companies seeking additional capital and business expertise. This would require setting up a structure and institutions to identify interested executives and companies. On the executives' side, Chambers of Commerce in a number of developed economies could be suitable organizations that would identify and screen potential investors. On the Rwandan side, the BRD, together with the Chambre de Commerce et d'Industrie du Rwanda and RIEPA, could centralize information on companies interested in joining the programme.

The institutions on both sides would provide the mechanisms to bring executives and companies together. Once partnerships have been forged, ODA could also play a role in increasing the transfer of skills by encouraging retired executives to enhance their involvement in the management of the companies, including by spending more time in Rwanda. ODA money could finance the travel cost of retired executives who have previously committed to invest a minimum amount of capital in a Rwandan company (say around \$25 000) and devote some time to its management. The limited expected financial return from the investment may indeed otherwise not justify the cost (travel and opportunity cost) of spending time in Rwanda to directly participate in the management of the company and to transfer business skills to locals.

3. Building a centre of excellence in soft infrastructure and governance

Hard infrastructure constraints need to be addressed forcefully in order to allow companies across the economy to become more competitive regionally and globally. Attaining regional or global

⁷⁶ Australia, Ireland, Singapore and even the United States have at least some elements of such programmes in place. In Africa, Mauritius is one of the only countries to have set up a scheme of this type.

standards in this area will require time and significant financial investment, however. While these issues are being addressed, the Government should *turn Rwanda into a centre of excellence in soft infrastructure and governance* in Africa.⁷⁷ In order to become “best in Africa”, Rwanda should obviously benchmark itself against countries on the continent, but it should also consider and aim at global best practices.

Excellence in soft infrastructure and governance could be a crucial element to differentiate Rwanda from other African countries, to overcome other weaknesses in investment conditions and turn the country into an attractive location for investors. Critically, it would also ensure that the national and consumer interest is protected, and that the potentially negative consequences of investments are avoided as much as possible. Excellence should be achieved in a number of areas, including:

- Governance: the zero tolerance policy towards corruption at all levels needs to be continued and reinforced;
- A "culture of service": the Government needs to promote a new mentality in public administration to ensure that a service-oriented attitude takes root, in addition to a regulatory and control attitude;
- Services to investors (licences, registration, facilitation, after-care): each administrative service should be required to draw up and make publicly available "client charters", which determine who the "clients" are, and what they are entitled to expect (procedures, timelines, etc.);
- Tax administration;
- Customs administration;
- Immigration services;
- Land registration;
- Commercial justice;
- Mining sector regulation and supervision;
- Regulatory bodies: this should include the central bank, RURA and all other regulatory bodies.

The implementation of the centre of excellence initiative would require a strong advocate within Government. The Minister of State in Charge of Industry and Investment Promotion should be directly responsible for the implementation, benchmarking and monitoring of the initiative, and should report to the Cabinet. Effective implementation would require monitoring through benchmarks. Benchmarking tools should be established to monitor two things: (1) the performance of each administrative service relative to its “client charter”; and (2) the performance of each administrative service relative to global best performers. These benchmarks would include monitoring the time to complete Customs procedures, obtain VAT refunds, secure work permits, obtain business licences, register companies, etc.

Achieving excellence will require a number of changes to the legal framework, as identified in chapter II. It will require even greater efforts to ensure that rules and regulations are applied appropriately and competently. International organizations, including UNCTAD, the World Bank and the IMF have already provided significant technical assistance in the areas of Customs, tax administration or bank regulation. The Government should intensify requests for support from the international community in areas where Rwanda needs to build its technical expertise.

⁷⁷ Soft infrastructure involves: (1) laws and regulations affecting investment and businesses; and (2) institutions and procedures to implement regulations.

In particular, it could ask the donor community to help it establish and finance a *retired executives programme*. Such a programme would place retired executives, regulators or technicians with demonstrated competence and knowledge of international best practices in their area of expertise on medium-term secondments in a number of administrations in Rwanda. They would act as advisors – i.e. without decision-making power – to the head of the administrative or regulatory service, and provide training for staff so as to maximize the transfer of competences. In order to be effective, secondments should entail full-time residence in Rwanda for an extended period of time, probably no less than two years.

The retired executives programme should focus on areas where technical expertise needs strengthening and would be particularly useful in:

- Telecommunications (RURA);
- Electricity and water (RURA);
- Transport (RURA);
- Banking (BNR);
- Competition (Ministry of Commerce);
- Mining (Ministry of Land and Mines);
- Commercial justice (Ministry of Justice);
- Environment (REMA);
- Customs (RRA);
- Immigration (Ministry of Labour);
- Land registration (Ministry of Land);
- e-governance.

4. Market enhancing measures and bilateral treaties

Rwanda benefits from the most favourable market access granted by the European Union and the United States under the EBA and AGOA initiatives. Its membership to COMESA also gives it preferential access to 18 countries in eastern and southern Africa. Yet, as was indicated above, Rwanda's potential export market is mostly subregional. It is thus essential that negotiations to join the EAC be concluded soon, that efforts to join SADC be further pursued, and that the Communauté Economique des Pays des Grands Lacs⁷⁸ (CEPGL) be revived as soon as political conditions allow, initially focusing on trade access.

While Rwanda's participation to preferential trade agreements is mostly appropriate, its network of DTTs and BITs is very rudimentary, and not sufficiently focused on potential source countries of FDI. As part of the improvement in soft infrastructure and the investment framework, the Government should immediately initiate negotiations on DTTs and BITs with Kenya, Uganda, the United Republic of Tanzania, and with a number of EU countries (Belgium, the United Kingdom) and the United States and Canada.

5. Bridging the image gap

As indicated earlier, Rwanda suffers from a large “image gap” in most parts of the world. It usually remains associated with the genocide and the instability in the Great Lakes region in spite of the tremendous achievements of the past decade in establishing political and social stability and personal

⁷⁸ The CEPGL includes Burundi, the Democratic Republic of the Congo and Rwanda. It is not operational at the moment, although the Treaty signed in 1975 provided for preferential trade access.

safety, in advancing social reconciliation and in reforming the economy. The gap between perception by the majority and the reality on the ground is thus vast, and needs to be bridged if Rwanda is to reap all the benefits of its structural efforts in promoting FDI. Image building is beyond the scope of this Review, but a number of initiatives can be suggested:

- The situation has improved enough recently to make it worthwhile to initiate a professionally executed image building campaign focused on the investors community;
- The Government should seek enhanced coverage by the international media, including the written press and television. It could, for example, seek publications like the Financial Times (United Kingdom) to feature a general "country supplement" on Rwanda or the New York Times (United States) to feature a "travel" article on gorilla trekking and other attractions;
- Embassies around the world could play a more active role in bridging the image gap by disseminating information and organizing targeted outreach events;
- The perception of Rwanda tends to radically improve upon a first visit. Tourism could thus be leveraged to bridge the image gap (see below).

E. Focused strategic initiatives

The “horizontal” measures proposed above could go a long way to promote business development and FDI and maximize the developmental impact of foreign investments. A number of sectoral policy measures should be considered as well, however. This section takes a brief look at a number of broadly defined sectors and considers the type of foreign investors that may be interested in investing, and what is likely to be their main market focus (national, regional or global). It then proposes a series of “policy packages” to make the sectors attractive to foreign investors so that they can contribute to widening the economic base and creating wealth and employment.

I. Manufacturing: focus on the basics, produce locally

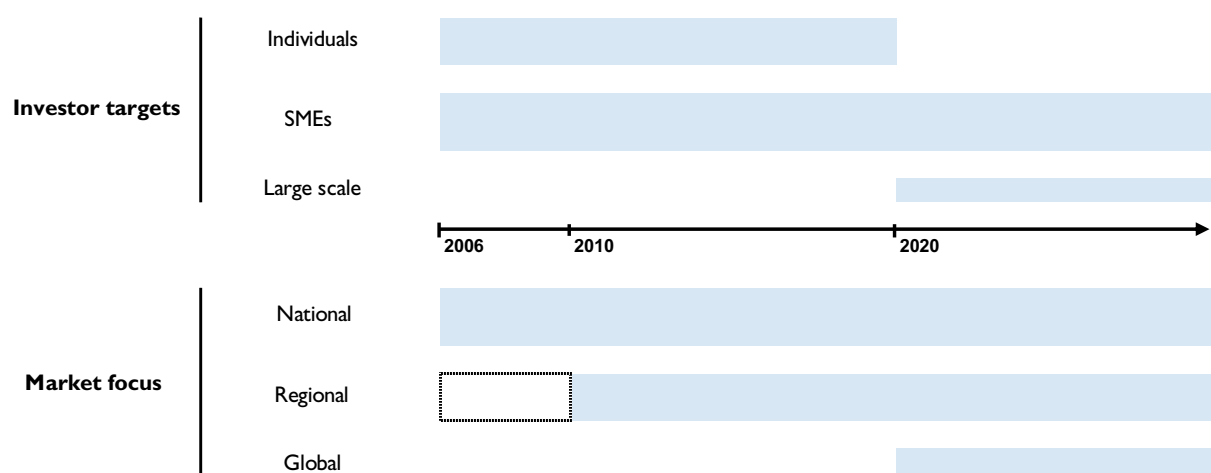
Rwanda’s industrial sector is in its infancy, and by and large remains virgin territory for foreign investors. Factors 1, 2 and 3 imply that Rwanda should initially focus its FDI strategy in the manufacturing sector on attracting two main types of investors:

- Individuals from the region and from the Diaspora;
- Small- and medium-scale enterprises⁷⁹ (SMEs), mostly from the region, and to a lesser extent from beyond.

These investors, in turn, will be most likely interested in supplying the local market or producing goods for the subregion. Although the national market is too small to attract large TNCs, the dominance of imported manufactured goods and high transport costs provide opportunities for niche investors to produce locally for the domestic market. Supplying the local market at first should allow companies to progressively build their competitiveness and for the manufacturing sector to gain depth and density. This would allow the sector to become regionally competitive in the medium term. Figure III.4 summarizes the type of foreign investors Rwanda should target and their likely market focus, over the medium term (2020) and beyond, and by degree of importance.⁸⁰

⁷⁹ SMEs are understood from a global FDI perspective, not as defined by what would be considered SMEs in a small economy like Rwanda.

⁸⁰ An indication of likely relative importance is provided by the thickness of each line.

Figure III.4. Investors and market focus timeline, manufacturing

Source: UNCTAD.

FDI policy package for manufacturing

Given the strategy highlighted above, a policy package to attract FDI in manufacturing would involve the following components:

a. Establish multi-facility industrial parks

The Income Tax and Investment and Export Promotion and Facilitation laws adopted in 2005 (chapter II) provide fiscal incentives for exporters⁸¹ under an EPZ regime that allows single-enterprise or multi-company zones. RIEPA, the supervisory agency, has identified land to set up an EPZ around Kigali and is pursuing further feasibility studies to provide some of the basic infrastructure to the area. Such a zone would compete directly with similar ones in the region. In particular, Kenya offers the same fiscal incentives, better infrastructure (utilities and particularly access to sea) and readily available semi-skilled labour.

Given the strategy advocated above to establish Rwanda as a centre of excellence in soft infrastructure and the country's limited export capacity and competitiveness in manufacturing for the global market, an alternative strategy is advocated, which does not rely on the EPZ concept. In effect, the EPZ regime could be replaced by an approach based on three elements:

- Fiscal incentives aimed at export activities, regardless of where they are undertaken, and whether they account for a large or small percentage of an investor's output;
- Multi-facility industrial parks, where *all* investors can benefit from above-average physical infrastructure;
- A freeport-style fiscal regime aimed at promoting Rwanda's potential role as a logistics and dispatch centre for the Great Lakes region.

⁸¹ Subject to exporting a minimum of 80 per cent of output, these consist mainly of: (1) 0 per cent income tax rate for an unlimited period of time; (2) exemption from withholding taxes on dividends and tax-free repatriation of profits; and (3) exemption from import and excise duties and VAT on capital goods and production inputs.

As indicated in chapter II, establishing Rwanda as a centre of excellence in soft infrastructure calls for the general fiscal regime to be the most competitive and efficient in the region. Instead of allowing exporters to benefit from permanent tax holidays, Rwanda should aim to set up a tax regime that proves attractive to all investors. This would be achieved by further reducing the corporate income tax rate and limiting the recent increase in the dividend withholding tax rate.

Incentives for export activities, in turn, could be offered to all exporters, regardless of where they are located and what proportion of the company's output is exported. The Government could thus replace the current EPZ regime with a dual rate system, whereby a company's export-based earnings are taxed at a lower rate (say 10 per cent) than domestic sales-based earnings. This would require precise regulations to determine the two types of earnings, but would have the benefit over the EPZ regime of not providing full and permanent tax holidays to exporters and of promoting all export activities. It would also be more appropriate to Rwanda, as it is more likely to attract exporters that would wish to sell both to the domestic market and to the region or beyond, in a proportion that may not be 20-80 as currently required to benefit from EPZ incentives.

Rather than dedicating scarce resources to set up infrastructure only for companies operating from EPZs, the Government could invest in the creation of a few multi-facility industrial parks with high-quality infrastructure. These would be open to *all* investors, whether domestic or foreign, exporters or not. It is likely that the first such facility, probably in Kigali, would have to be developed by the Government. It would require: (1) setting land aside; (2) developing access and estate roads; and (3) providing high quality utilities.

The clustering of manufacturing and/or services firms in dedicated parks with better-than-average infrastructure would be more likely to promote learning-by-doing and linkages between domestic and foreign investors than narrowly-defined EPZs. While the initial push for the first estate will likely come from the Government, RIEPA should actively seek investments by private park developers, who would be in charge of building, promoting and running the structure.

The development of Rwanda as a logistics and dispatch centre for the Great Lakes region, in turn, could be facilitated through a special arrangement allowing tax-free transit and handling of merchandise in bonded facilities. Freeport facilities could relatively easily be developed around Kigali with the appropriate regulations.

b. Ensure optimal regional market access

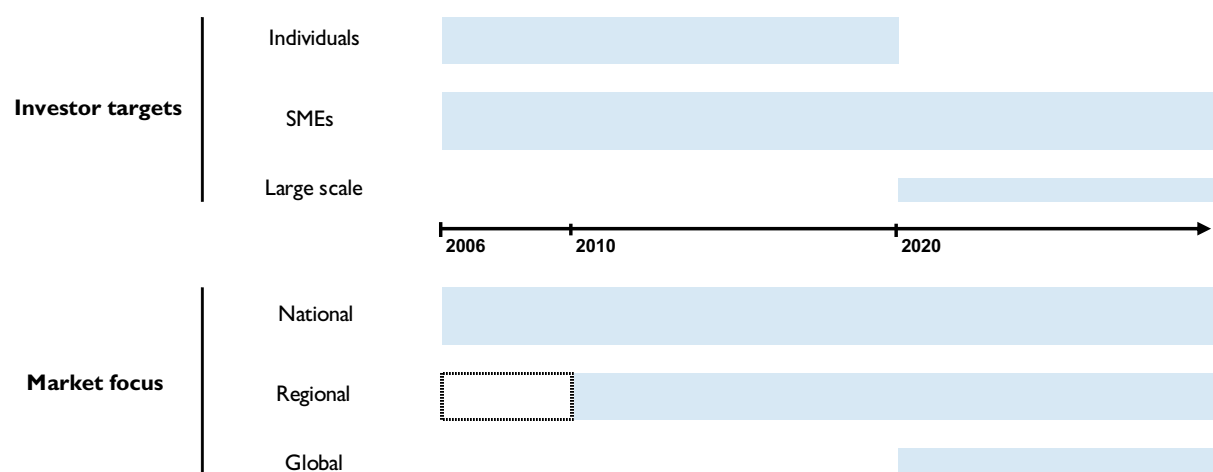
Although foreign investment in manufacturing is likely to focus on the domestic market at first, it could – and should – be used as a stepping stone towards exporting to the region. Given the long lead times in negotiating trade agreements, it is important that Rwanda secure optimal market access to the main regional economies. This is partly provided for under COMESA, but should be further pursued under the EAC and SADC, to which Rwanda has applied. The target should be to attain full membership to both of these arrangements by 2010 at the latest. The strategic importance of the Democratic Republic of the Congo as a potential export market for Rwanda means that securing improved market access should be a priority for the Government, despite all the difficulties it entails. Such efforts could take place through a revival of the CEPGL, on a bilateral basis, or through SADC, as the Democratic Republic of the Congo is part of the group.

2. General services: focus on the essentials

Rwanda's services sector⁸² is slightly more developed than the manufacturing sector, but foreign investors are not present to any significant extent either, and a wide range of services are not available at the level of quality and in the quantity required by large TNCs. The shortage of human capital is a particularly severe constraint for the services sector, as it is typically skills-intensive but requires relatively low levels of physical capital.

As a result, the strategy of FDI attraction in the services sector should in many ways mirror that of the manufacturing sector. It should seek to firm up the breadth and depth of the services sector, serving the domestic market at first, and targeting the regional market at a later stage (figure III.5). Given the prevalence of human capital in services investments, the role of foreign individuals bringing their skills and talents will be particularly important for services FDI.

Figure III.5. Investors and market focus timeline, services



Source: UNCTAD.

FDI policy package for services: contractor indigenization

Given the current limitations on the availability of a number services, the public and private sectors frequently hire foreign domiciled contractors for some of their needs. For many such services providers, this experience is their first exposure to doing business in Rwanda. This exposure provides an opportunity for Rwanda to encourage non-resident services providers to put down roots by establishing affiliates in Rwanda and investing in business expansion.⁸³ Moreover, providers will usually sojourn in Rwanda for periods while executing contracts and can readily be contacted by RIEPA.

Contracted services are likely to include construction and related services such as engineering, surveying and electro-mechanical services. They would include legal services, business consulting, a range of ICT services and other commercially relevant trades and services. The construction industry can be taken as an example of the potential power of a contractor indigenization programme in which a foreign

⁸² ICT, tourism and financial services are considered separately below.

⁸³ The aim would be to encourage services providers to establish a commercial presence rather than doing a simple cross-border supply, potentially backed by a temporary presence of personnel.

construction contractor is encouraged to establish an affiliate in Rwanda. A local affiliate is more likely to develop local facilities and skills and thus increase the domestic content of future contracts. The affiliate would be in a position over time to branch out into related areas such as own-investment in property development. In time, foreign affiliates can be potential investors and operators in public infrastructure concessions under PPP-type programmes. It would be useful for Rwanda to begin laying the grounds now for these capabilities.

A number of measures could be considered to promote contractor indigenization. As the single largest buyer of services, the Government is in a position to entice foreign suppliers of services to establish stronger roots in Rwanda through its procurement rules.⁸⁴ The National Tender Board was set up in 1997 to organize and manage the public procurement process and to implement the general public procurement policy on behalf of the Government. A strict set of rules and regulations was established to promote transparency, economy and equity. A draft Procurement Law is currently under examination that should provide a preference to bidding companies established in Rwanda. This preference is limited to a maximum of 10 per cent of the total bid price, and does not contravene Rwanda's international obligations as it is not a party to the WTO's Plurilateral Agreement on Government Procurement.

This price preference could favour contractor indigenization, as long as the preference also applies to foreign-owned bidders that have established a substantive commercial presence in Rwanda. Particular care should then be given to ensure that "local bidders" are not just shell companies providing little local content. Similarly, the National Tender Board should apply the price preference carefully to ensure that the quality of service is properly taken into account and that the Government does not purchase excessively expensive services.

For private sector purchases of services, price preferences for locally established suppliers obviously cannot be mandated. Other incentives could be investigated to encourage purchase of services from locally domiciled suppliers, however. Possible measures include: (1) allowing over 100 per cent tax expensing to companies that purchase designated services from qualified local service providers;⁸⁵ and (2) permitting withholding tax paid by non-residents on services income to be credited against future tax liability from subsequent business in Rwanda if it is conducted by a locally established affiliate. These measures to support contractor indigenization are suggestions rather than firm recommendations. They would require detailed consideration to ensure that they are practical and effective and consistent with Rwanda's international obligations.

3. Tourism: widen the focus

Rwanda has not been able so far to capitalize on its location within one of the most visited regions in sub-Saharan Africa. Although no comprehensive data are available, the number of foreign visitors per capita is among the lowest in the world. Its reliance on a single tourist attraction – mountain gorillas – also imposes a strict constraint, as the resource is fragile and very limited. The number of visits to national parks⁸⁶ started falling a few years before the genocide with the political and military instability

⁸⁴ This might be attenuated by donor rules governing procurement, bearing in mind the important role of aid in funding government services in Rwanda. Donor rules may prohibit discrimination against contractors who remain domiciled at home.

⁸⁵ Possible criteria to be a qualified service provider would include: (1) a legal criterion of residence such as incorporation and filing of a tax return as a resident entity; and (2) substantive presence as measured by local full-time employees.

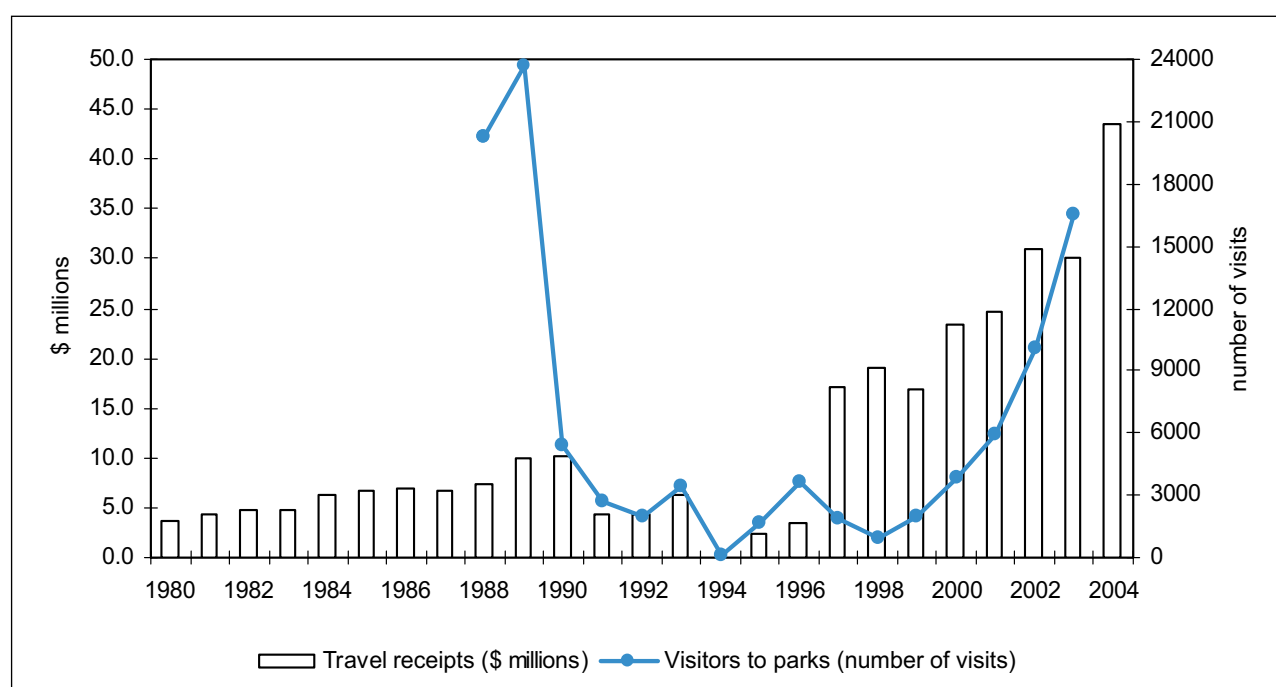
⁸⁶ Rwanda has three national parks: (1) the Parc National des Volcans, which is the home of the mountain gorillas; (2) the Nyungwe Forest National Park, a mountain forest with 13 species of primates and almost 300 bird species; and (3) the Akagera National Park, a typical savannah park, which has nevertheless suffered in recent years as a result of resettlement of populations and a low density of wildlife.

in the Democratic Republic of the Congo, which borders the Parc National des Volcans. Visits virtually stopped in 1994, and only started recovering in 1998 (figure III.6). Total visits to national parks were 16 500 in 2003, still short of the number in 1988-1989. Travel receipts, in turn, have recovered faster and far surpassed the average of the 1980s at \$43 million in 2004. Much of this is not related to “leisure” tourism, however, but rather to the increase in business travel, and more significantly still to the large presence of foreign aid organizations and international NGOs.

Vision 2020 accords the tourism industry high priority for a number of reasons: (1) it can be a major source of employment and poverty reduction; (2) it can decentralize economic activity; and (3) it generates foreign exchange earnings. The Ministry of Commerce, Industry, Investment Promotion, Tourism and Cooperatives has developed a comprehensive tourism policy, which constitutes a sound evaluation of the constraints and opportunities of the tourism sector. The key aspects of the policy are:

- A decision to target high-end, high-cost eco-tourism, and to stay away from mass tourism;
- A recognition that Rwanda must market itself through a regional eco-tourism circuit and seek to lengthen the stays of visitors who come for gorilla watching and business;
- A recognition of the high cost of Rwanda as a destination, the unsatisfactory quality of services⁸⁷ and a persistent image problem;
- A recognition that private investment must drive the development of the sector, under improved regulatory supervision by the Government.

Figure III.6. Travel receipts and visits to national parks, 1980-2004
(Millions of dollars and number of visits)



Sources: Ministry of Commerce and Industry, and IMF, Balance of Payments Statistics.

⁸⁷ Particularly given that high-end tourism is targeted.

The strategy recognizes that Rwanda will not – and should not – seek to attract tourists in very large numbers. At the moment, only four groups of mountain gorillas have been “habituated” for tourist visits. A maximum of 8 people can join on a tour, which can be organized only once a day. This limits the maximum number of permits that can be attributed to watch mountain gorillas to about 12 000 per year. The preservation of mountain gorillas will not allow that number to increase significantly in the future.

The development of the tourism sector into a significant industry through private sector investment will require some diversification around the flagship gorilla product. The decision to focus exclusively on high-end eco-tourism (and business tourism) may thus be too restrictive. Rwanda would benefit from developing a second “axis” to its tourism sector, in an area where it may also have a comparative advantage. Such a sector may revolve around “backpacking” tourism, which is also far from the “mass tourism” that Rwanda wishes to avoid. Rwanda has a definite comparative advantage in that segment, as a result of the diversity of landscapes within a relatively small territory, a comparatively dense road network, and a very secure environment throughout the country – although this is not widely known outside Rwanda.

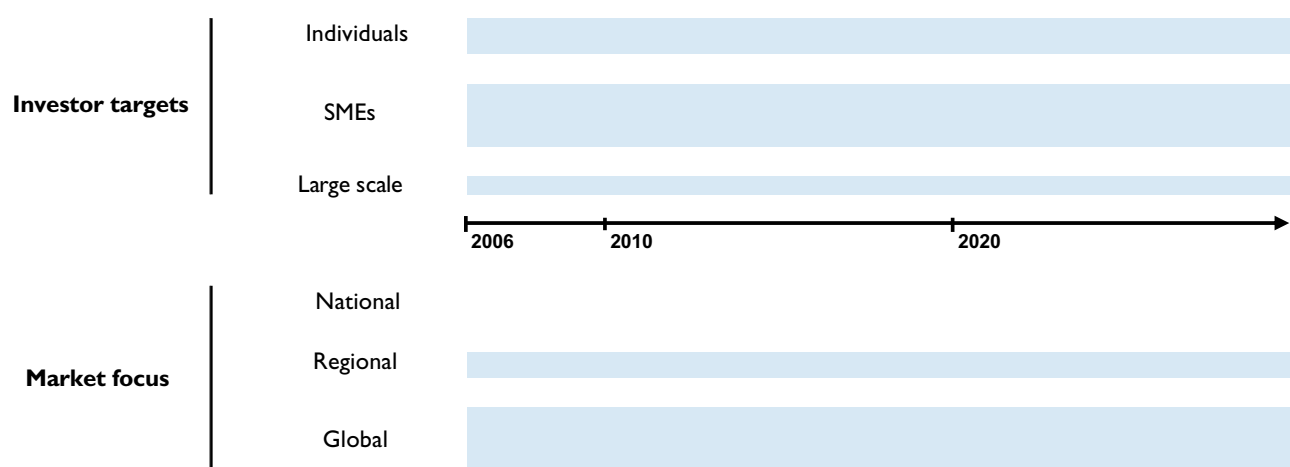
Attracting backpackers, however, would require that they at least have a chance at visiting Rwanda’s main attraction, the mountain gorillas. At the current price of \$375 per permit, most backpackers would be priced out of the market. It may thus be advisable to make a limited number of permits available at a reduced price through a lottery system. In order to ensure that these reduced-price permits benefit the targeted backpackers and are not subject to a black market, they could be restricted to people under a certain age, say 30, and be nominative.

Given this twin axis of high-cost/low-cost tourism, the role of foreign investors could be particularly important in a number of areas:

- Setting up high-quality services, which Rwanda does not have experience of;
- Establishing backpackers services, which Rwanda does not have experience of (trekking, adventure outdoors activities, ...);
- Providing better and more diversified ancillary services (restaurants, car and motorbike rental, recreational facilities, entertainment);
- Bringing boutique investments (rather than large hotel chains);
- Bringing individuals who will cater for backpackers needs.

The type of investors most likely to provide these services is summarized in figure III.7. The market orientation of the sector, given its high-end and backpacking focus, would be global with particular emphasis on European and North American visitors.

Aside from its contribution to development, employment – including in rural areas – and FDI inflows, the tourism sector could, in and of itself, participate in Rwanda’s FDI strategy. As indicated earlier, Rwanda suffers from a severe image deficit, which affects not only tourism, but also foreign investment in general. Yet, people’s image of the country tends to change drastically upon a first visit. Increasing the *number* of visitors – without hoping or aiming to becoming a mass tourism destination – could thus make a contribution to rebuilding the country’s image and bring additional investment.

Figure III.7. Investors and market focus timeline, tourism

Source: UNCTAD.

Given these elements, the sectoral strategy should focus on:

- Targeting boutique investors (services providers and tour operators) present in Kenya, Uganda and the United Republic of Tanzania. These investors, whether from these countries or elsewhere, have a demonstrated experience in the type of investments Rwanda is seeking and are in the best position to package and market Rwanda as part of an "East Africa" destination.
- Preparing legislation that allows classification and monitoring of hotels according to strict criteria. The classification and monitoring should focus on the upper-end of the market, without placing undue restrictions and burden on the lower-end aimed at the "backpacker" segment, where "comfort" expectations are low. The legislation could include an "eco-tourism" label, attributed to hotels complying with a strict set of rules concerning environmental protection.
- Promoting FDI in ancillary services. The development of high-end eco-tourism and backpacking tourism will not be possible without improvements in ancillary services (restaurant, entertainment, recreational facilities, etc.). A number of these services may require relatively little up-front financial investment, but significant skills and knowledge of markets. Individuals from the region and beyond may be in a good position to provide these services. Implementing the business talent programme may thus be critical to the success of the tourism sector.

4. ICT: think local and regional

The ICT sector was the first for which a systematic development strategy was elaborated. The first five-year action plan for the period 2001-2005 was part of a drive led by the President aimed at converting Rwanda into a knowledge-based economy by 2020. The 2001-2005 ICT plan was detailed and included several specific FDI targets. Some of the targets were clearly unrealistic (for example, targets of attracting FDI inflows of \$500 million for ICT infrastructure development and at least five Fortune 500 companies to outsource computer services and develop software). Yet, there is no mistaking the drive and leadership to bring Rwanda quickly to the forefront of ICT in the region. The new action plan for 2006-2010 will be released shortly and targets and measures for the longer term to 2020 are about to be addressed.

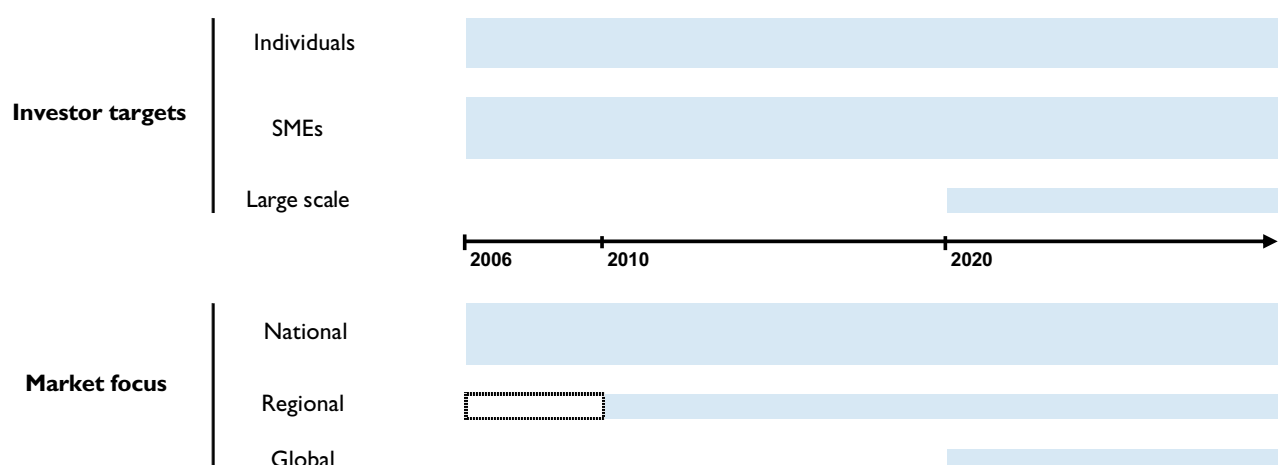
There have been successes. These include the privatization of the fixed line operator to Terracom, which included network expansion obligations. Terracom has separately engaged in deploying a fibre optic cable network between Government ministries and business centres. A consortium of commercial banks in partnership with the central bank (SIMTEL) is rapidly introducing an electronic payments network. The education system is also beginning to address the need to raise computer literacy at schools and the supply of IT skills from university.

Most importantly the IT sector strategy recognizes and proposes solutions to key constraints in the development of this sector and the attraction of FDI. These constraints are quite similar in nature to those facing other sectors:

- The domestic market is small, especially the private sector market. The Government's accelerated programme to e-enable government functions is providing a starting base to attract investors. Further, the focus for enhancing market size is recognized to be the regional rather than global market (figure III.8). This market will take the form of various IT services and software rather than internet-enabled services (ITES), such as business process outsourcing. The SIMTEL initiative is planned as a platform to support Rwanda's goal to become a regional hub for online banking.
- International connectivity (currently by satellite) is regarded as too expensive to support global ITES. Although ITES opportunities are in any event restricted by skill shortages, there are "starter" opportunities such as call centres and data entry operations that are less skill-intensive but require low-cost/high-speed connectivity. Discussions are well advanced by a consortium of south and east African telecoms operators to lay a submarine fibre optic cable from South Africa to Sudan by the end of 2007. The cable (named EASSy) would give global connectivity via links with other cables. Terracom is a member of the EASSy consortium and plans are that Rwanda could connect to EASSy via Uganda and Kenya to a cable landing proposed at Mombasa. There is concern that the incumbent telecom operators will use their ownership of the cable to entrench their dominance in international gateway operations, i.e. by imposing expensive charges to non-consortium members for access. It will be in Rwanda's interests to ensure that Terracom permits access to third parties on the same terms as its own access to the cable.
- IT-related skills are still in short supply and they are a critical factor in developing the higher value-added areas of the industry such as software services and business process outsourcing (BPO).⁸⁸ In the short term there is a strong case for providing incentives for companies that provide in-house training. This is part of the package being offered to companies that locate in "private software parks" (i.e. designated buildings). Longer term the Government is boosting expenditure of IT awareness in schools and IT training at tertiary level.

A proactive programme to attract the Diaspora to invest in developing Rwanda's fledgling IT industry is underway. The business model of one such investor, e-tools, illustrates many of the strategic issues and how investors are responding to them to drive forward this key sector in Rwanda's development strategy (box III.2).

⁸⁸ Mauritius, which has about 100 companies in the sector (and is thus indicative of where Rwanda should aim in the next 5-10 years), is finding that skills shortage is restricting development. It produces about 1500 IT graduates a year. Source: Financial Times, Special Report on Mauritius (14 March 2006).

Figure III.8. Investors and market focus timeline, ICT

Source: UNCTAD.

5. Banking and finance: go offshore

Rwanda's financial system is small, unsophisticated and dominated by commercial banking. A mere 7 per cent of the population has a bank account, mostly with the Union des Banques Populaires du Rwanda (UBPR), a union of cooperative banks. The client base of the six commercial banks (chapter II, section D.II) is limited to around 10 000 commercial and 100 000 individual clients.⁸⁹ Among these, commercial banks compete for a restricted core of about 50 large clients, which include the largest corporations, embassies, international organizations and NGOs. The requirements of these main clients consist mainly of simple foreign exchange transactions and short- to medium-term borrowing in local and foreign currency.

In spite of its small and unsophisticated nature, Rwanda's banking system has been one of the magnets for FDI attraction in recent years (chapter I). Yet, it is unlikely that the banking sector will attract foreign investment to create new banks in the medium term, even though additional FDI could be attracted through the planned privatization of the BRD and in insurance and other financial services.

A more successful strategy would likely rest upon allowing existing banks to expand the range of services that they are allowed to provide, building upon the proven expertise of foreign investors. One particular area that deserves attention and further investigation is the provision of offshore banking services. Market research to establish whether there is a business case for developing an offshore financial services centre (OFSC) in Rwanda should be undertaken. This research should establish the conditions under which funds could be attracted and assess the demand for borrowing and other financial services that could be provided. For example, Mauritius and Cyprus attract funds to their offshore centres due to favourable tax treaties with India and Russia, respectively. They are a conduit for third country investment in these key treaty partners. On the other hand, Botswana's more recently established International Financial Services Centre rests on the country's strong fundamentals of stability and sound financial management. Some other offshore financial centres are pure tax havens that principally offer a minimum of regulation and paperwork.

⁸⁹ IMF (2004b).

Box III.2. e-Tools in Rwanda

Electronic Tools Company™ (e-Tools) is a Californian software company founded in 1987 by Rwandan residents in the United States. It develops e-government and e-commerce software as well as business solutions that are customized or can be readily adapted for multiple customers. In 2002, the company was approached by the Government to invest in Rwanda and help kick-start the local software industry. It is involved, in turn, in approaching other Diaspora members in the IT industry, asking them to come home or to contribute in technology skills transfer. Its current core customers in Rwanda are government agencies for software tools including:

- BudgetMaster™ and PIPMaster™ – tools to manage the Government’s budget preparation and execution (already operational in the Ministry of Finance and Economic Planning);
- TaxMaster™ – a tool to manage collection of national taxes, including a taxpayer interface;
- GateKeeper™ – an immigration software system for border controls and management of passports and visas. It has been installed in the immigration department and has been used at Kigali International Airport for over a year;
- PublicBooks™ – a tool to manage public accounting (already operational in the Ministry of Finance and Economic Planning);
- SFAR MIS™ – a tool to manage Government’s scholarship programmes;
- DMVMaster™ – a tool to manage vehicle registration and licensing;
- CentralBankERP™ – a tool to manage central bank operations (under development).

These products have a customer interface and are locally adapted. This includes adding interfaces in Kinyarwanda, as well as in English and French. Local adaptation provides a competitive edge over foreign-sourced products.

Acknowledging that the local market is small, the company is actively promoting the products successfully installed in Rwanda to the region. Regional language options, such as Swahili will be included. Products are being marketed as “Made in COMESA”. An office has been opened recently in Kenya. Additional product development for niches in the regional market is underway. For example, e-tools has developed a package called Documents™ to combat petty corruption and improve management oversight in the official handling of documents. It foresees a large market in the region to help governments find technological solutions in response to the problem of corruption.

In the absence of a pool of local IT graduates, e-tools recruits science (and some IT) graduates and trains them in-house. It calls on employees and associates worldwide, which includes other Rwandans from the Diaspora to provide training.

Source: investor interview.

The market research should also identify whether there is a demand for substantive services from offshore clients. Many, but by no means all, countries want OFSCs to have substance. They should provide tangible services so as to increase employment and skills and not just recycle tax-advantaged funds to other jurisdictions. The OFSCs of Botswana and Mauritius have these aims.

Rwanda's business case would likely rest on providing offshore financial services to support the development of Rwanda as a subregional logistics hub facilitating trading and goods transit with the eastern part of the Democratic Republic of the Congo and Burundi (section E.1). Positioning Rwanda as a centre of excellence in regulation and governance – as proposed in this report – with excellent IT facilities and first-rate trade facilitation would complement this background. An OFSC would provide offshore banking services – including lending, leasing, factoring and trade finance – to support these activities. Related services such as company administration and insurance could complement the core activity of offshore banking.

If market research is positive, work could begin in the near future on developing a policy package to make offshore banking attractive and well regulated. Expert advice would be needed on regulatory and taxation issues and on the institutions needed to promote and regulate the sector. Elements to be considered are as follows.

a. Regulatory issues for offshore financial services

Banking regulation

Offshore banking business means enabling locally based financial institutions to deal with non-residents in foreign currency. Since offshore banks do not take deposits from residents nor, in principle, lend to them they are not subject to the same degree of prudential regulation as licensed domestic banks. Nevertheless, for reputational reasons it is desirable that they operate to high standards and are usually supervised by the central bank. Compliance with international anti-money laundering standards is part of this, and will be particularly important for Rwanda as operators in the Democratic Republic of the Congo would constitute a sizeable portion of the “market” for the OFSC. The licensing regime would either be to allow licensed commercial banks to operate offshore banking units (OBUs) or to have a separate class of licensed offshore banks, which may or may not have a domestic banking presence. Singapore adopted the first approach and Mauritius the second. Rwanda might prefer to take the OBU route. Attaching the offshore banking opportunity to the domestic commercial banks enhances the development and deepening of the commercial banking sector.

Foreign exchange controls

Offshore banking transactions should not be subject to foreign exchange control since all transactions are legally extra-territorial. Restrictions on foreign currency deposits from and lending to non-residents would thus have to be lifted for OBU operations. This would not necessarily apply to the rest of the banking system.

b. Taxation issues for offshore financial services

A supportive taxation regime is required to attract funds and to attract providers of services. Funds invested by non-residents should not be taxed. An OFSC would otherwise not be competitive with other countries. Similarly equity invested in managed funds (which, in turn, invest in foreign assets) should not be taxed. Relief from withholding tax should be unilateral and not dependent on double tax treaties.

The providers of offshore financial services must also be tax advantaged in various ways to encourage their establishment and enable them to attract skilled professionals. Careful design is needed to encourage

OFSCs to create new business or undertake specialist work. Apart from relieving tax on income some additional measures may be desirable including consolidation of OBU expenses with those of domestic banking entity for income tax purposes. Some offshore centres, such as Mauritius, also give temporary relief on personal tax for key skilled professionals.

c. Market enhancing measures for offshore financial services

An obstacle in attracting offshore banks will be the limited pool of funds and customers. Consideration would need to be given to market enhancing measures such as:

- Allowing returning Diaspora to be considered as non-resident in respect of foreign currency funds brought from abroad for deposit with offshore banks. The aim is to increase the pool of funds. The Diaspora would not be taxed on the interest earned;
- Allowing regional logistics providers and regional headquarters operations to be deemed non-resident and thus eligible to utilize offshore banking facilities. This enables offshore banks to attract low taxation on services provided. Care needs to be taken to ensure that tax incentives lead to business creation rather than business diversion. Sri Lanka's OBUs were permitted to lend to EPZ operators and paid no tax on the income generated. Even though zones are extra-territorial and the operators "non-resident" in that sense it is likely that such lending would have taken place anyway on a conventional, taxed, basis;⁹⁰
- Encouraging the development of Rwanda as a regional logistics hub will provide natural support for OFSC development, provided that qualified regional logistics operators are deemed non-residents;
- Encouraging the Democratic Republic of the Congo and Burundi to relax foreign exchange controls on the capital account would materially assist the development of an OFSC in Rwanda. This would help Rwanda to become a legal safe haven for regional funds as distinct from a "flight capital" centre. Neither Uganda nor Kenya has foreign exchange controls and Rwanda could position itself directly as an offshore banking centre for these countries.

6. Coffee, tea and agriculture: pursue diversification

a. Coffee and tea

FDI prospects in the traditional tea and coffee industries are clear but limited. The two products are the mainstay of Rwanda's exports, but there is relatively little room for volume growth in output. The Government's objective is thus to improve quality, branding and local value-addition.

Coffee growing, processing and marketing are open to private investment, including FDI, as is the agricultural supply industry. Coffee growing is dominated by smallholders, and there is little scope for expanded estate production by corporate investors. Exporting and processing is carried out by five integrated exporters/processors, supplemented by growers' cooperatives. The two largest private exporters have partial foreign ownership. As a major thrust to improve quality standards, the Government is fostering investment in independent washing stations that transform coffee cherries into parchment beans.

Although Rwanda's coffee sector is very small by world standards (accounting for only about 0.4 per cent of world output), favourable climatic and soil condition offer good prospects to produce high quality

⁹⁰ UNCTAD (2004). Investment Policy Review of Sri Lanka.

specialty coffee, and regulations allow full participation of the private sector in the industry. Given these conditions and the Government's objective to move up-market and increase local value-addition, foreign investment could be promoted in the following areas:

- Washing stations. The Government hopes to have 60 per cent of the crop fully washed locally by 2010, compared with 3 per cent currently. This would require investments of around \$10 million in an additional 80 washing stations. There has been little private investment so far, and unreliable electricity supply remains a problem for washing stations in remote areas. Although prospects for FDI are unclear, such projects may appeal to small investors from the region.
- Coffee roasting and production of specialty coffee. The main Government objective for the sector is to produce specialty roasted coffee for exports. While there is local expertise to increase the quality of coffee, national investors probably have insufficient knowledge of western markets and branding to be successful by themselves. RIEPA's targeting effort should thus focus on attracting one major brand with such expertise.

Rwandan tea, in turn, is grown 65 per cent by smallholders and 35 per cent by estates. As for coffee, there is little domestic value addition or branding, as output is sold largely by tea factories in bulk, typically by auction in Mombasa. The sector is organized around nine tea factories, which have associated estates and also process smallholder production. All of these factories used to be state-owned. One was partially sold in 2004 to Lab International (United Kingdom), one is close to privatization, and the remaining seven have been earmarked for privatization.

The privatization of these factories and their estates offers room for further domestic and foreign private investment in the sector and for further improvement in yields, quality and beneficiation. It is estimated that current yields could be almost doubled if they were to reach the best international standards. Aggregate investment to acquire all tea factories could be upwards of \$40 million, with additional investments needed for replanting and factory upgrading.

The privatization of tea factories and estates and private investment in the coffee sector could generate foreign investment in the near future. The two sectors would also benefit from FDI, particularly to help them move towards better quality production and higher domestic value addition. In many respects, however, tea and coffee are mature sectors that do not offer significant prospects for sustained volume growth or FDI attraction in the medium term. Given the current policy environment in tea and coffee, the sectors should thus not be at the centre of the FDI strategy.

b. Diversification in agriculture

While the coffee and tea sectors are close to maturity, there are a number of activities in agriculture that have been little or not explored so far, but that have a potentially strong growth potential and provide opportunities for rural development, FDI attraction, job creation and exports. The production and export of flowers, fruits and vegetables may be such an opportunity to diversify and enter markets for high-value products suitable for airfreight.

The success of this industry in neighbouring Kenya, and to a lesser extent in Uganda, in exporting to Europe points to what can be achieved. Indeed, the horticulture and floriculture industry in sub-Saharan Africa as a whole has now overtaken the traditional exports of coffee and cocoa. The Rwandan industry is clearly in its infancy: apart from the notable pioneering effort of Rwanda Flora (chapter I, box I.2), these significant changes in African agriculture have not reached Rwanda yet. The disruptions caused by the genocide may be partly responsible as the take-off of this industry in Africa occurred in the 1990s. Yet, the success stories in neighbouring countries show that an industry can develop quickly from humble beginnings and that business leadership can resolve many issues such as transport logistics, adherence to sanitary and phytosanitary standards and smallholder support, some of which have traditionally been the preserve of governments (box III.3).

Box III.3. FDI and horticulture and floriculture in Kenya

Kenya's success in providing high-quality products at competitive costs and in fulfilling strict sanitary and phytosanitary standards (SPS) is the result of private investment and initiative, as the flower, vegetables and fruit sectors have been subject to relatively little government intervention through extension services to farmers or public marketing boards. Exports by these three sectors have consistently increased as a share of total exports over the past decades, growing to an aggregate of close to 23 per cent in 2003, equivalent to \$550 million, from less than 6 per cent in 1980.

Horticulture and floriculture were initially launched by small investors (e.g. Homegrown) with very little capital. A number of the initial investors have grown considerably, however, and large firms currently dominate the sector, with 24 industrial operators accounting for 72 per cent of total export volume. The dominance of large firms is not due to capital intensity, however, but results from the need to meet the demanding standards of buyers for food safety, traceability, environmental impact and labour standards. Indeed, flower, vegetable and fruit production are very labour-intensive, and cut flowers alone employ 40-50 000 people directly and another 60-70 000 indirectly. While the distribution side of the three sectors is dominated by foreign investors, linkages with the domestic agricultural sector are sizeable – particularly in the flower and vegetables sectors – as locally-owned outgrowers frequently take part in production.

Two key areas of technological competence are essential in distributing and selling products to the EU and US markets. The first is to ensure adequate traceability and environmental standards. While this is widely recognized to act as a disincentive to small-scale producers, some of the largest (foreign-owned) exporters use small-scale outgrowers, and provide them with the extension services they need to sustain their market position.

The second key area of technological competence lies in the control of logistics. Kenyan growers and packers add value to fresh vegetables by undertaking the full range of pack-house activities, including washing, packing and labelling the produce with store-specific packaging and labelling. Their control over logistics and production allow their European customers to change their purchase requirements up to the middle of the day of dispatch in large airplanes flying to Europe every night. Similarly, logistics in the flower sector enable the full cold-chain storage of flowers immediately after picking, which allows supermarkets to guarantee their produce for one week after sale from the store.

Source: *Investment Policy Review, Kenya, UNCTAD (2005)*.

The Rwandan industry appears to be making a humble beginning, similar to that of Kenya in the 1990s. Yet, there is an opportunity to significantly accelerate its development by availing of the experience and infrastructure already developed and tested in neighbouring countries, particularly Kenya.

Rwanda's land and climatic conditions could also lend themselves to the production of other high-value, low bulk agricultural products. In particular, conditions may be favourable for herbal products, whether used in medicines, health supplements or beauty and toiletry goods. The global market for herbals was estimated at more than \$60 billion in 2002 and was consistently growing at an annual rate of 10-15 per cent. India has been a key player in the sector, both as a market and as a producer (box III.4). While the herbal sector is virtually non-existent in Rwanda, it could be the target of foreign investment promotion efforts. Potential benefits in case of successful development include diversification of rural income, regional development, export earnings and job creation.

Box III.4. Indian FDI in herbals products

Dabur, Zandu, Baidyanath and Himalaya are among the leading herbal companies in India, with strong brands, expertise, research and development facilities and financial strength. A number of them have invested overseas, including Dabur and Zandu, which invested in Nepal.

Dabur Nepal Private Limited (DNPL) was formed as a joint venture 80 per cent owned by Dabur India Limited. The company began operations in 1992, and initially produced herbal air oil, tooth powder and other powders, before expanding to other products. Two of DNPL's projects have generated strong backward linkages with the Nepalese economy: an apiary project and a medicinal plant project. The medicinal project has accomplished the following results:

- It conserved and propagated threatened medicinal plants and provided employment and income to local communities;

- It provided technical assistance, seeds and planting to Nepalese farmers for the cultivation of medicinal plants;

- It carried out scientific studies and research for the sustainable cultivation of medicinal plants;

- It produced value-added products for domestic and export markets.

DNPL supplies saplings to outgrowers directly or through development agencies and national/international NGOs at cost price. The outgrowers are given training and technical assistance for plantation, cultivation practices, plant protection measures and harvesting, as well as post-harvesting technology. DNPL guarantees purchase of the final produce at prevailing market prices. This project helped Nepal cultivate medicinal plants on marginal and often unused land, and promoted employment creation and income generation for people in remote areas.

Source: Investment Policy Review, Nepal, UNCTAD (2003).

FDI policy package for agri-business

A number of measures should be implemented to establish the necessary conditions to entice investment in agribusiness:

- Identify and make available adequate parcels (in terms of size, location and quality of land) for acquisition by investors seeking to form a nucleus estate;
- Encourage the provision of extension services to outgrowers by estate investors. This could take the form of fiscal incentives,⁹¹ and/or direct subsidies;
- Adopt the strict SPS set by international markets into Rwandan law. This should be limited to export products such as flowers and herbals, however, as it would make no sense to adopt such standards for staple food produced and consumed locally;
- Set up procedures to fast track Customs and SPS clearances of perishable products;
- Exempt imported inputs from Customs duties;
- Ensure good telecommunications access, including internet, in the main growing areas;
- Allow private investment in cold-storage facilities at Kayibanda Airport.

As these conditions are being set up, RIEPA should actively promote and target the sector. Its efforts should focus on:

- Promoting horticulture and floriculture to Kenya-based investors. Emphasis should be put on Rwanda's main assets, including the quality of roads, safety of staff and good air links to Jomo Kenyatta Airport;
- Identifying and targeting potential investors in the herbal sector, including Indian investors.

After identifying potential investors, RIEPA could actively promote their participation in the sector by preparing briefing notes on investment conditions and inviting selected executives to visit Rwanda. These visits should not only aim to inform potential investors of opportunities in Rwanda, but also to allow RIEPA to collect information on additional conditions that may be needed for these companies to invest.

7. Mining: promote and develop industrial mining investment

Rwanda has historically been perceived more as a buying and transit centre for minerals originating in neighbouring countries than as a mining location in its own right. The mining potential was little explored before independence as Belgium focused its investments in the minerals-rich Congo. Since independence, the mining sector has received little strategic attention, and has been dominated by the artisanal production of coltan (colombo-tantalite), cassiterite and wolfram. The Régie d'Exploitation et de Développement des Mines (Redemi) was established by the Government in 1988 to take over 20 concessions from the bankrupt Société des Mines du Rwanda (Somirwa), itself a partnership between Géomines of Belgium and the State of Rwanda.

Redemi has been the principal operator of mechanized mines. Its infrastructure was severely damaged during the genocide, however, and a number of its concessions are not currently mined. It exported only \$1.6 million worth of minerals in 2000, and the Government has started to privatize Redemi through the sale of its concessions to private investors. Other key players in the sector are Pyramides (box III.5), Rwanda Metals and Metal Processing Association, which operate processing and smelting facilities.

⁹¹ One option would be to allow deductions from the corporate income tax base over and above the actual cost of providing extension services. Another option would be to grant a reduction in the corporate income tax rate based on the proportion of output sourced from outgrowers.

Box III.5. Pyramides (s.a.r.l.): new directions in Rwandan mining

Pyramides is a mining and minerals processing company owned 50 per cent each by Egyptian and Rwandese interests. The partners' relationship developed from minerals trading interests. The company was formed in 2000 and awarded seven concessions to mine coltan. The company currently exports about \$3.5 million of coltan concentrate and expects to export product to a value of \$30 million in five years time (equivalent to one third of total exports in 2004).

Several features of this investment illustrate the challenges, opportunities and potential impact of mining FDI in Rwanda:

The existing geological survey maps do not show the concessions as being prospective for commercial mining. Pyramides was alerted to the mineral potential through its minerals buying operations. It suspected that some of its mineral purchases originated in Rwanda and not just the Democratic Republic of the Congo.

The foreign partner had no mining expertise at the outset and has developed his knowledge through a process of trial and error. The first concession required an investment of \$2.5 million to yield a throughput of 50 tonnes per hour. The second concession will require an investment of only \$1 million for a throughput of 100 tonnes per hour.

Rwanda's tantalite ore does not require crushing and grinding prior to metallurgical recovery treatment. It thus lends itself to artisanal mining methods. Apart from its own operations, Pyramides assists artisanal miners to produce ore on its own concessions. It buys the ore for treatment and deducts a charge for services and facilities provided to the small miners. There are about 80-100 small miners on each of its concessions.

There is potential for further processing of the concentrate. At present, the concentrate exported is 25 per cent coltan and no value is obtained from the remaining metals and impurities. Pyramides is considering the construction of a \$1 million refinery in Kigali to further process its own concentrates and those from independent sources – both Rwandese and regional. The refinery may be a joint venture with its main Chinese customer.

As a result of the logistics difficulties entailed in importing its mining equipment, Pyramides is planning to establish an equipment leasing venture. It will import and lease equipment and supplies to independent miners based on minerals purchase contracts.

Source: investor interview.

The lack of strategic attention paid to the sector over the past decades and the poor state of the geological survey mean that little is known about Rwanda's actual potential in the mining sector. However, existing geological data indicate that there may be significant potential (at the scale of Rwanda) and the Government is giving more strategic attention to the sector and putting in place a favourable framework for private investment in industrial mining (figure III.9). The three main initiatives currently underway are:

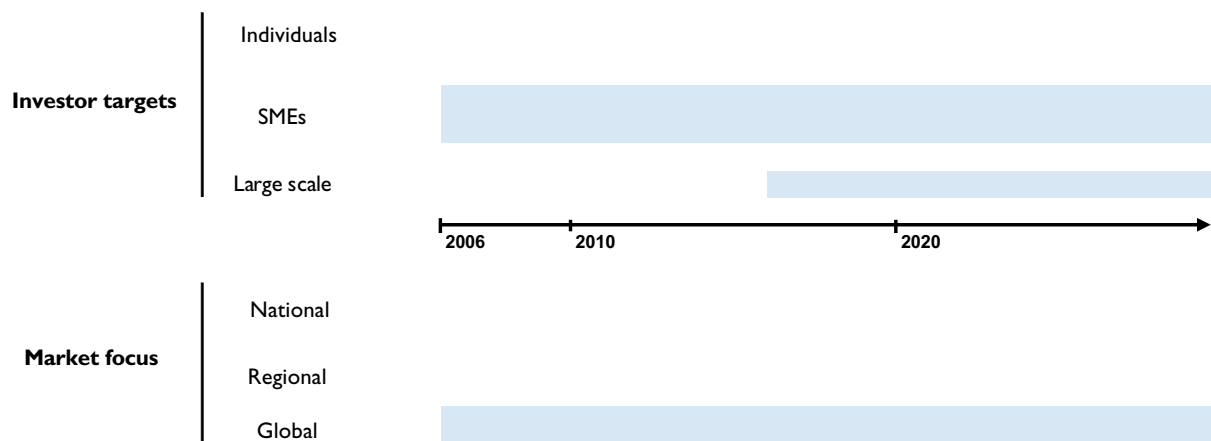
- The preparation of a new mining law and regulatory framework for the mining sector (chapter II);
- The improvement of the geological survey and centralization/digitization of all available data, with donor support;
- The privatization of Redemi's concessions.

FDI policy package for mining

These initiatives are three necessary steps towards the development of industrial mining and the attraction of foreign investors in the sector. The Government requested UNCTAD's assistance in evaluating the legal and regulatory framework and proposing a strategy of foreign investment promotion and foreign investor targeting in industrial mining.⁹² The strategy provides a number of concrete recommendations, focusing on:

- The fiscal regime for mining. Rwanda does not currently have special provisions for the taxation of mining investments. Virtually all mining countries have such provisions, and UNCTAD recommends that Rwanda adopt them as well if it wishes to attract quality foreign investors. These provisions do not include tax holidays or rebates on the corporate income tax rates, but account for specificities of mining investments, particularly in terms of amortization of assets, dollar accounting and deductibility of certain expenses;
- The structure of the institutions in charge of mining promotion;
- The main components of suggested promotion efforts (promotional literature, trade publications, trade fairs, road shows, website) and actions to be taken;
- A careful approach to the policy of beneficiation. While it is legitimate that the Government seek to maximize local value addition of its minerals, it should not adopt an over-regulated approach to beneficiation, as it could nip mining investments in the bud. Beneficiation should be encouraged through improvements in infrastructure (power and transport in particular) and competitiveness. It should not be forced upon mining investors if it is not commercially viable, as it would prevent investment in the mining sector altogether, and hence prevent the future development of processing industries.

Figure III.9. Investors and market focus timeline, mining



Source: UNCTAD.

⁹² UNCTAD (2006). Strategy for the Promotion of the Industrial Mining Sector.

The strategy also offers guidance in terms of targeting foreign investors. Given the scale of existing mining operations and the poor state of the geological survey, Rwanda will at first need to attract “juniors” that focus on high-risk prospection and exploration activities. The involvement of “majors” is unlikely until a large commercial deposit has been discovered, and this would most likely take place through a farm-in with a “junior”.

The strategy recognizes the need for Rwanda to attract reputable investors in the mining sector, the need to set up a efficient and well-enforced regulatory framework (to deal with the adverse effects of mining operations), and the need to deal with the taint that has affected minerals trade in the Great Lakes region over the past decade (box III.6). In turn, mining investments could provide significant employment in rural and remote areas, generate secondary developmental effects, and promote infrastructure development to the benefit of the economy as a whole.

Box III.6. Rwanda mining: between a rock and a hard place

The illegal exploitation of mineral resources has been a major source of finance for parties involved in a number of conflicts in Africa. This has been the case in the Democratic Republic of the Congo, which has abundant mineral resources, from gold to diamonds, coltan and other high-value, relatively low-bulk ores. The collapse of State institutions in the Democratic Republic of the Congo and the distances and lack of means of communication between the capital and the eastern part of the country have favoured illegal mining activities in recent years, engulfing neighbouring countries in the situation, including Burundi, Rwanda and Uganda.

The United Nations’ Security Council requested a special report on the *Illegal Exploitation of Natural Resources and Other Forms of Wealth in the Democratic Republic of the Congo* in 2001. The report sought to identify key players in the illegal minerals trade and the consequences of these activities, and to recommend measures to put an end to such practices. The report highlighted that significant quantities of coltan and small quantities of gold were illegally traded through Rwanda and participated in the financing of the conflict in the Great Lakes region. It identified a number of companies and individuals, mostly traders, who should be subject to financial restrictions or travel bans. It also identified a large number of companies deemed in violation of the OECD guidelines for multinational enterprises (including Alfred Knight, Anglo American, Barclays Bank, Belgolaise, De Beers, Fortis and a number of large TNCs).

The illegitimate or unregulated trade of coltan in the late 1990s placed a significant taint on Rwanda’s own mining sector. A bona fide company like Pyramides was initially – and wrongly – put on the blacklist, despite operating legitimate coltan mining operations in Rwanda, and significant efforts were made by the investors to be taken off the blacklist. The Government – and potential investors – will thus need to pay particular attention to show that their mining operations are legitimate, and not perceived by the international community as a “front” for illegal trade in minerals from the Democratic Republic of the Congo. A well-designed and well-monitored regulatory framework is the only way to remove the taint of minerals from Rwanda. The draft mining law is the first step in that direction, but it will only be effective if an efficient and competent regulator is created to enforce the new rules and regulations.

Sources: U.N. Security Council, *Final report of the Panel of Experts on the Illegal Exploitation of Natural Resources and Other Forms of Wealth of the Democratic Republic of the Congo*, 2002.

In particular, a major discovery of commercially exploitable base metals – a very uncertain but not impossible prospect – and the involvement of a “major” could bring significant benefits to the economy as a whole as it could make it economically viable to set up a rail connection to the ports of Mombasa or Dar-es-Salaam, or to connect Rwanda to the South African power grid. Such an eventuality remains very uncertain and based on the geology of Rwanda, and would – if it were to happen – be a least 10 years away.

UNCTAD’s strategy was presented at a workshop of national stakeholders in Kigali at the end of March 2006. It was positively received and the Ministry of Lands, Environment, Forestry, Water and Mines is pressing ahead with the reforms. The task force charged with setting up the future regulatory body, the Office de Géologie et des Mines du Rwanda (OGMR), is also making rapid progress and has indicated that it will take on board a number of UNCTAD’s suggestions.

F. Strengthening peace and stability through investment

Rwanda restored peace and stability very rapidly after 1994, and it has become one of the safest countries in sub-Saharan Africa, with some of the lowest incidences of corruption. This remarkable achievement is due to the country’s own political and social efforts. The adoption of the new Constitution in 2003, the creation of Gacaca courts and the handling of land issues upon the return of refugees were major steps towards justice, reconciliation and entrenching peace.

These efforts at the social, judicial and political levels will remain the key factors for peace, stability and reconciliation in the future. Economic development, however, will also be a crucial element and should build upon peace and stability and reinforce them in turn. The pressure on scarce natural resources, lack of jobs in the formal sector, under-developed civil society and low level of education likely played a role in the recurrent conflicts between communities after independence, culminating in the genocide of 1994.

The pressure on land and scarce natural resources and the shortfall of employment opportunities remain an unresolved challenge. As highlighted earlier, Rwanda will need to go through a rapid process of economic transformation in the coming decades if it is to engage on a sustainable development path. As understood by the Government, private investment will be the main driver of this process. As a result, private investment (local and foreign) will contribute to peace and stability through six main channels:

- Providing employment opportunities outside of traditional subsistence agriculture;
- Lowering pressure on natural resources (particularly land) and providing alternative means of wealth creation;
- Contributing to the urbanization of the country;
- Building Rwanda's human capital;
- Contributing to a strong civil society;
- Putting pressure on the Government to ensure good governance and building strong and fair institutions.

The two key “horizontal” recommendations of this Review (centre of excellence and skills attraction and dissemination programme) could go a long way towards strengthening public institutions and reinforcing their accountability, and complementing the Government’s efforts to build human capital through general education. The key contribution of this strategy of investment promotion, however, will result from the

employment opportunities it could create across a wide range of sectors and regions. The need to develop the country as a whole calls for investment promotion to touch upon all sectors of the economy.

Although Rwanda has a low incidence of corruption, foreign investors (particularly the larger ones) should make all efforts to adhere to the OECD Guidelines for Multinational Enterprises. They should also make particular efforts to adhere to the spirit of the laws and avoid exploiting potential weaknesses in the regulatory or institutional framework. The “induction programme” linked to RIEPA certificates (chapter II) is one way to encourage compliance with the laws.

Similarly, foreign investors should make all efforts to avoid any kind of discrimination in employment practices and contribute to the training of their staff. The skills attraction and dissemination programme proposes concrete measures to strengthen foreign investors’ role in building human capital. One additional measure the Government could consider would be to require larger investors to provide language courses (English or French) to their employees to ensure bilingualism (English and French, in addition to Kinyarwanda).⁹³ This would reinforce the Government’s efforts to provide education in English and French.

G. Priorities, timelines and implications for RIEPA

I. Priorities and timelines

The “horizontal” approach to FDI promotion means that no single sector should receive much higher priority than the other in the FDI strategy. This is not to say, however, that there should be no priorities in Government actions towards the implementation of the strategy. To the contrary, the Government should aim to achieve the actions according to the timetable presented in table III.3.

Table III.3. Timetable for government action

Action	Deadline
1. Set up the skills attraction and dissemination programme	2007
2. Set up benchmarking tools and “client charters” for administrative services	2007
3. Set up and recruit officers under the retired executives programme	2007
4. Set up multi-facility industrial parks	2007
5. Initiate review of key sectoral initiatives	2006
6. Adopt revised legal framework for mining and investment promotion strategy	2006
7. Organize “executives visits”	2006
8. Set land aside for agri-business investors	2006
9. Initiate negotiations of DTTs and BITs with selected countries	2006
10. Join EAC	2007
11. Join SADC	2008

⁹³ FINA Bank already offers such courses on a voluntary basis, with great success.

2. Potential paradigm shifts

Rwanda's economic transformation – and the type of FDI that will help and accompany it – will be evolutionary rather than revolutionary. A number of factors/initiatives could bring paradigm shifts that could generate opportunities for leapfrogging. Such opportunities include:

- A connection to the South African power grid, which would at once provide a solution to the availability, reliability and cost of power.
- A railway connection to the coast to Mombasa or Dar-es-Salaam. Both would represent a giant step towards lifting hard infrastructure constraints, but their costs currently make them uneconomical given the level of economic activity in Rwanda. Yet, an event like the discovery of a large commercially exploitable deposit of base metals could be sufficient to make them economical.
- The development of e-government and spread of ICT throughout the economy.
- The transformation of Rwanda into a "centre of excellence in soft infrastructure and governance".

3. Implications for RIEPA

It was agreed with the Government that this Review would not provide a detailed assessment of the institutional arrangements for promoting FDI. It should nevertheless draw attention to the implications of its strategic findings for the work of RIEPA. RIEPA is the sole agency within the Government charged with FDI promotion. It is also responsible for supporting national investors and for export promotion. Although RIEPA is a relatively small agency, its resources cannot be expanded given general restrictions facing government departments and agencies, and they are broadly adequate. Implementing the strategy recommended in this Review would call for RIEPA to:

- Strengthen its advocacy role and take leadership role in promoting the skills attraction and dissemination programme and the centre of excellence in soft infrastructure and governance;
- Keep the focus of investment and export promotion efforts on the region, with well targeted initiatives beyond that;
- Take the responsibility for coordinating a professionally executed image building campaign;
- Further develop its aftercare services and use them as a tool for investment promotion. A number of existing foreign investors are quite bullish about Rwanda. They are potentially the country's best promoters and could attract foreign partners, hence reinforcing RIEPA's own work. Aftercare services could thus be made more systematic and partly geared towards promotion, image building and advocacy;
- Organize visits by executives to a wide variety of sectors, seeking potential investor's feedback on investment conditions.

IV. MAIN CONCLUSIONS AND RECOMMENDATIONS

Rwanda is at a turning point of its economic development. The Government is fully committed to reducing poverty and improving standards of living by fostering a private sector-led process of economic transformation to reduce the country's dependence on agriculture. Non-agricultural job creation is imperative in order to provide welfare and economic safety to the population and ensure long-term social and political stability. The challenge is the speed with which this transformation has to be undertaken – a pace that only a few countries have achieved. Moreover, Rwanda faces special obstacles given its geographical position. The nature of the challenge is underlined by the Government's goal to transform Rwanda into a knowledge-based economy by 2020.

High levels of investment by the private and the public sectors will be required. Domestic private investment will be the main driving force for development. Foreign aid is in a position to support some of the necessary public investment in infrastructure and human capital (education, health). FDI, in turn, could provide an important contribution, even though inflows have been low so far. FDI will be especially important in catalyzing the substantial upgrading of business-related skills that will be required in what is now largely a pre-industrial society. It will complement the Government's major drive to upgrade general education.

This Review has found a concerted and well-targeted effort by the Government to address fundamental weaknesses in the investment climate it inherited. Peace, stability and personal safety have been restored. Macroeconomic conditions are sound and stable. Consistent improvements have been made in the investment framework. Regulatory institutions have been strengthened. Corruption is low and is not tolerated by the leadership. Infrastructure impediments are being addressed. A development strategy is in place that foresees a strong role for private investment to consolidate the recovery of infrastructure and institutions that is supported by public investment and aid. This creates an opportunity to develop a supportive FDI strategy.

Much still needs to be done in the investment area. Further modernization is needed in the investment framework and regulatory institutions are in their infancy. An FDI strategy needs to be elaborated with specific measures and programmes that address development goals and recognize Rwanda's strengths and weakness. Such a strategy will have to be realistic. Certain key constraints in infrastructure, global market access, domestic market size, and education levels will be binding, at least in the medium term. But there are also opportunities that good policy, excellent governance and a focused FDI strategy can help to realize. These are the main building blocks as summarized below.

Although it is difficult to predict future FDI flows, the successful implementation of the strategy could set Rwanda on a path to attracting annual inflows of about \$50 million by 2010 and \$300 million by 2020 (compared with around \$7 million on average between 2001 and 2004). These inflows might seem modest, but their impact will be magnified if they contribute to a rapid deepening of business skills and the emergence of Rwanda as a strong competitor within its region.

A. A centre of excellence in soft infrastructure and governance

Many of Rwanda's hard infrastructure constraints to (foreign) investment (international transport, electricity, network of domestic suppliers) will remain binding in the medium term, with regional standard

being achievable at best. In contrast, Rwanda has the potential to differentiate itself from its neighbours and confound its hard infrastructure handicap by turning itself into a *centre of excellence in soft infrastructure and governance* in Africa. The progress to date suggests that this aim is achievable. The aim of the centre of excellence would be two-fold:

- Create a seamless, supportive and well-regulated business environment for both domestic and foreign investment (laws, regulations, institutions and procedures). The Government should aim to be internationally recognized as a centre of excellence by around 2010;
- Ensure appropriate regulation of business to protect the public and national interest. "High-quality" investment is most likely to occur under a well-regulated framework and appropriate regulations are the best avenue to address concerns about the potential adverse effects of investments (including environmental damage, health and safety concerns and anti-competitive market behaviour).

I. Make good governance systematic

Rwanda has a low incidence of, and a zero-tolerance policy towards, corruption. This itself helps differentiate Rwanda from regional competitors. Beyond fighting corruption, excellence in governance will require that a culture of service be developed in public administration. A service culture already exists in RIEPA, which has frequent contact with investors. But regulatory institutions are in their infancy and there is little experience of exercising appropriate oversight and judgement in dealing with business. Capacity building is vital and the risk of regulatory failure is high. The recommended measures are:

- Each administrative service should draw up and make publicly available "client charters", which determine who the "clients" are, and what they are entitled to expect (procedures, timelines, etc.);
- Promote a new mentality in public administration to ensure that a service-oriented attitude takes root, in addition to a regulatory and control attitude;
- Support a rapid build up in technical expertise in the regulatory agencies through an aid-funded retired executives programme. This programme would be most useful in the following areas: (1) telecommunications; (2) electricity and water; (3) transport; (4) banking; (5) Customs; (6) competition; (7) mining; (8) commercial justice; (9) land registration; (10) environment; and (11) e-governance;
- Appoint the Minister of State in Charge of Industry and Investment Promotion to benchmark and monitor administrative performance, and have him report to Cabinet. Benchmarking tools should be established to monitor both performance in relation to client charters and client charters themselves in relation to best practices. These benchmarks would include monitoring the time to complete Customs procedures, obtain VAT refunds, secure work permits, obtain business licences and register companies, etc;
- Speed up the delivery of commercial justice, which is widely perceived by investors as fair but slow. In part, judges would be assisted by having more modern laws to enforce (see regulatory gaps below). But more judges should be trained to adjudicate commercial cases and a first class commercial conciliation and arbitration centre should be created.

2. Fill the gaps in general business regulation and taxation

Rwanda is already a good performer by regional standards in several areas of the investment framework. This includes trade facilitation (except for facilities), investment facilitation, telecommunications regulations, environmental regulations, VAT administration and land law (though not administration). The principal remaining areas of the regulatory regime which need to be reformed to reach a centre of excellence standard are:

- Introduce a next generation of RIEPA certificates, which would include:
 - No minimum capital requirement, except for entitlements to work and residence permits;
 - Extension of the present foreign investor protections to all foreign investors, but conditional upon participation in a corporate compliance and business ethics programme;
 - Eligibility requirements that induce holders to comply with Rwanda's key business laws, corporate social responsibilities and good business ethics.
- Make specific improvements in corporate taxation of investment to remove uncompetitive elements and promote important outcomes:
 - Make the tax base more competitive. Retain the current accelerated tax depreciation provisions but improve rates of depreciation generally and extend loss carry-forward rights so that the full benefit is obtained;
 - Reduce withholding rates on non-resident dividends to 10 per cent and in the near future lower the headline rate of income tax to 25 per cent;
 - Remove the 3 per cent charge imposed by MaGeRwa, which amounts to a tax;
 - Strongly incentivize staff training, in particular while companies train their personnel to make up for shortfalls in the public education system;
 - Ensure full consistency between the three language versions of the fiscal laws and regulations and improve clarity in tax regulations.
- Set up a comprehensive duty drawback scheme for exporters;
- Bring the regulatory framework for electricity, transport and water – the backbone business services – up to the level of the telecommunications regulations;
- Develop new company, bankruptcy and contract laws and mandate an appropriate set of accounting standards;
- Implement a competition regime, duly calibrated with respect to the issues of ensuring competitive outcomes in a small market;
- Within international norms of labour protection, introduce greater labour market flexibility with respect to longer trial periods and lower redundancy costs of terminating indefinite term jobs.

3. Inform the world

Rwanda's progress in improving the business climate is not reflected in perceptions abroad, which are still dominated by the genocide. A professionally executed programme is needed to ensure that there is full pay-off in new investment attraction from the centre of excellence programme and other policy initiatives. The main purpose would be to bridge Rwanda's image gap and bring perceptions in line with the new reality of the country.

B. A skills attraction and dissemination programme

The rapid acquisition and dissemination of business-relevant skills in new areas of manufacturing and services is imperative to achieve Rwanda's thrust towards a knowledge-based economy. The Government's educational programme will lay the foundation for this and is already showing results in increased literacy and school enrolment. Meanwhile there are significant gaps in technical, managerial, entrepreneurial and professional skills which will not be quickly closed by the formal education system. FDI, accompanied by well-designed skills dissemination programmes should be used to accelerate the skills development process. Three policy measures are suggested:

- Review immigration laws and policy to introduce a business talent scheme and improve the expatriate employee scheme;
- Enhance the training and skills dissemination features of the work and residence permitting scheme;
- Introduce a business mentoring programme.

I. Skills dissemination and expatriate employee scheme

The current work and residence permitting scheme allows established companies to import only a limited set of skills not available in Rwanda (university degree is required). The skills that can be imported are too restricted, and the scheme does not optimize the dissemination of knowledge and competencies to nationals. A reformed expatriate employee scheme is suggested to achieve three goals: (1) ensure a wide dissemination and transfer of skills; (2) ensure that employers have access to the skills that they need, whatever formal level of education these require; and (3) make the process more efficient. The dissemination of skills would be optimized by replacing the existing “understudy” programme with company-wide training and localization obligations. These obligations could be linked to the number of expatriate workers, turnover, or a combination of these and other factors.

Improving the efficiency of the allocation of work and residence permits would, in turn, involve replacing the current system of allocating work permits on a case-by-case basis following labour market testing with a more efficient “front-loaded” approach:

- Draw a list of skills that are in short supply at the national level. For these predetermined skills, the sponsor (employer) would not need to prove that it cannot find a qualified national to fill the position. The list should be widely defined initially, as the skills gap is important, and should not be limited to competencies requiring higher education;
- Screen sponsors based on their track-record of good-practice in employing expatriate workers (training programmes, no excessive recourse to expatriate workforce, no overstays, etc.). Sponsors with a good track-record would be subject to less extensive verification than sponsors without track-record or with a poor one;
- Unify work and residence permits and lengthen the period of issuance to cover periods of up to three years.

2. Full-fledged business talent scheme

The Government recognized the potential benefits of attracting individual investors by creating an investor visa in the Investment and Export Promotion and Facilitation law of 2005. This initial step should be turned into a full-fledged business talent scheme to promote the wide acquisition and dissemination of business-relevant skills. In many respects, the scheme would mirror what the Government has successfully achieved in luring Rwandans from the Diaspora to return home. The scheme would be structured along the following lines:

- Create "investor permits" for skilled individuals investing in Rwanda, with minimum capital requirements used to prevent illegitimate use of the permits by non-residents;
- Provide permits for nuclear families. Individuals need to be allowed to move to Rwanda with members of their nuclear families, who should also be permitted to work in the business;
- Provide certainty on permits. Individuals need to have sufficient certainty that their permit will

be renewed as long as the business is in operation. Guidelines and conditions as to how and under what conditions permanent residence status (or citizenship) can be gained should also be established.

- Require entrepreneurs obtaining investors' permits to set up training schemes for their national workers;
- Promote the integration of newcomers into Rwanda's social fabric by imposing language requirements (English, French or Kinyarwanda). Investors may be required to be fluent in one of the three languages to obtain the permit, or at least make a firm commitment to learn it, and be subject to a test after a number of years.

In addition to *allowing* skilled individuals to establish and set up businesses in Rwanda, the Government would need to put in place measures to *entice* them to do so. Possible measures include:

- Duty-free import of personal belongings upon installation;
- Non-resident status for personal income tax purposes for a limited number of years;
- Special provisions for the transfer of funds abroad;
- Support services for installation (finding housing, schooling, medical care).

Once an appropriate policy and regulatory framework has been put in place, the Government would have to actively promote Rwanda as a destination not just for investment by corporations, but for skilled individuals to invest and reside in. This promotion and awareness effort would be best targeted at individuals from within the region with some prior knowledge of Rwanda.

3. Business mentoring scheme

Rwanda could establish a business mentoring scheme, which would combine the features of retired executives programmes (see above) and those of “business angels” programmes. The main purpose of the scheme would be to bring together: (1) development-minded retired business executives who are willing to put some seed capital into a Rwandan company and to contribute their expertise on a part-time basis; and (2) promising Rwandan companies seeking additional capital and business expertise. This would require setting up a structure and institutions so as to identify potentially interested executives and companies, and bring them together. ODA money could be used to entice retired executives to spend additional time in Rwanda to optimize the transfer of business skills. This would be subject to eligibility requirements, including a previous commitment to provide management support and a minimum capital investment in the local company.

C. Focused strategic initiatives

Moving towards a centre of excellence in soft infrastructure and setting up the skills attraction and dissemination programme would go a long way in turning Rwanda into a more attractive business location, fostering foreign direct investment, and promoting the kind of private-sector led economic transformation that the Government aims to achieve. These “horizontal” measures should be the core of Rwanda’s FDI promotion strategy. This is unconventional. Most countries’ FDI strategies propose a highly targeted approach to investor attraction. But it must be realized that Rwanda is likely to attract smaller foreign investors, mostly from Africa, and focussed on the domestic and regional market. They may often be individuals and family businesses. Often they will be from the Diaspora. A Fortune 500 approach to supply the global economy will be illusory in almost all sectors at this juncture. This horizontal approach

should be supplemented with focused “vertical” strategic initiatives in a number of sectors to boost investor attraction. These are summarized below:

- **Manufacturing.** Since medium-term prospects rest on facilitating local production of basic goods, and progressively moving towards regional exports, recommended supporting policy measures are:
 - Establish multi-facility industrial parks with better-than-average infrastructure and open to all investors. These could serve as the basis for the development of clusters of manufacturing companies, domestic and foreign, and promote linkages and learning-by-doing. A traditional export processing zone approach would tend to exclude much prospective manufacturing investment at this stage;
 - Establish a free-port style fiscal regime aimed at promoting Rwanda’s position as a logistics and dispatch centre for the Great Lakes region.
- **General services.** Since medium-term investment prospects also rest on providing basic services for the local and ultimately regional market additional initiatives recommended are:
 - Set up a contractor indigenization programme to leverage investment opportunities arising from Government services procurement. IT services and construction are obvious examples;
 - Introduce fiscal incentives to promote local purchase of services by private companies.
- **Tourism.** The aim should be to widen the current focus on “high-end” tourism to include backpackers tourism, for which Rwanda has a comparative advantage. This would be consistent with attracting small foreign investors. It could be supported by providing some permits for gorilla treks to backpackers at lower prices either directly or as an incentive attached to the construction of budget accommodation.
- **ICT** sector strategy has received comprehensive strategic attention. The announced initiatives to accelerate skills development and improve infrastructure are consistent with the core proposals of this report. Contractor indigenization is also likely to play a significant role in developing the ICT sector.
- **Finance.** The domestic banking sector is a small market. Offshore financial services for the region offer prospects, especially if twinned with the development of Rwanda as a logistics and trade centre. Design of regulatory, tax and market enhancing measures is recommended if market research shows that the development of an offshore financial services centre could attract investment.
- **Coffee and tea** are mature industries with limited new FDI prospects. The potential for attracting foreign investors into flowers, vegetables and herbal products should be more systematically researched. The executives visits programme (see below) is a vehicle for rapid assessment of prospects and necessary government support.
- **Mining** warrants special attention and is receiving it. Rwanda’s mineral potential is still largely unexplored, even though the sector could potentially contribute significantly to development, including through job creation, income generation in rural areas, secondary economic effects and infrastructure development. UNCTAD is working with the Government on a strategy of FDI promotion in industrial mining that seeks to complement the Government’s efforts to revive

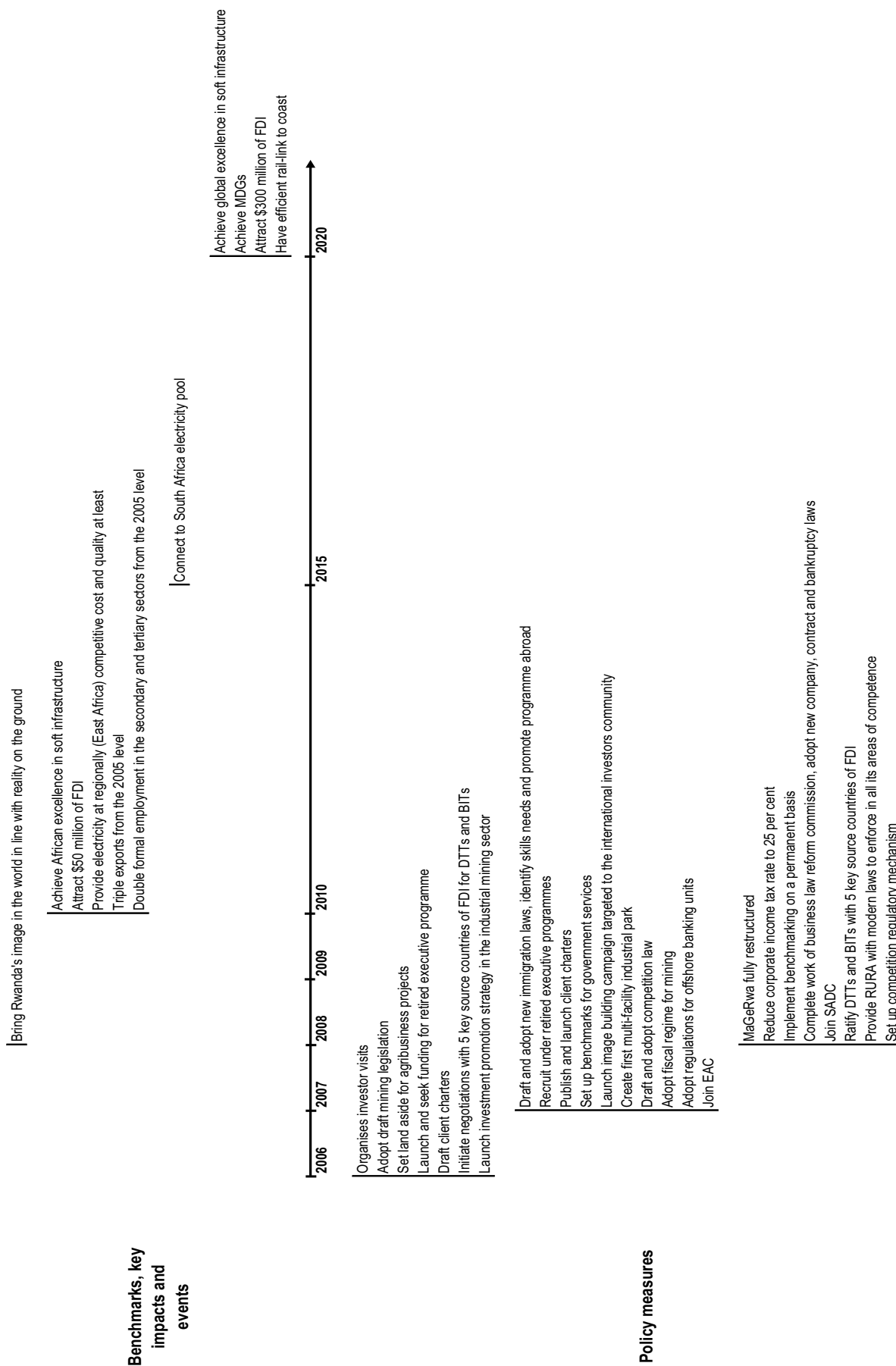
the sector through a new mining code. Mining represents one of the few conceivable paradigm shift events for Rwanda. The discovery and subsequent development of a major base metals mine could underwrite a rail link to the coast and connection to the cheap power available from the Southern African Power Pool. These outcomes would alter significant structural constraints for the economy at large.

- **Market enhancing measures.** These should advance on a broader front. The focus on joining the East African Community is appropriate. This should be complemented by investment and double tax treaties to support inward investment and supply of services to and from the relevant markets.
- **Executives visits programme.** To a large extent, Rwanda remains virgin territory for foreign investors and an economy where almost everything needs to be built. It is difficult under such circumstances for policymakers to precisely identify areas that need additional vertical measures to attract investment. RIEPA should invite executives from targeted companies to visit Rwanda to assess commercial potential and advise on key infrastructure and policy support needed to attract investment. Priority should be given to: (1) ICT, e.g. by inviting software firms from India; (2) horticulture/floriculture, focusing on firms established in Kenya; (3) herbals, inviting firms from India or China; (4) tourism, inviting companies specializing in eco-tourism and the backpacker market.

D. Action plan timeline

The measures and strategy proposed above can be summarized into an action plan timeline, with expected impact on economic structure and FDI as follows.

Figure IV.1. Action plan timeline



ANNEX: METHODOLOGY OF INTERNATIONAL TAX COMPARISONS

The Comparative Taxation Survey compares taxation on investment in several sectors in Rwanda with taxation in other selected countries – neighbours and countries elsewhere that have succeeded in attracting FDI to the sectors concerned. These comparisons enable Rwanda to assess the competitiveness of its taxation.

Taxation affects the cost of investment and its profitability, and thus the return on investment. This impact is not just a question of looking at the headline rate of tax on profits. The tax burden on the investor depends on a number of factors and their interaction, including expenses allowed, rates of capital allowances (tax depreciation), the availability of tax credits, investment allowances and tax holidays, the loss-carry-forward provisions and the taxation of dividends among other things. Moreover, Customs tariff and excise duties affect the cost of investment and operating margins. Together these make up the overall fiscal regime that affects the cost of and return on investment.

Comparative tax modelling is a method of taking into account the most important of these variables in the fiscal regime in a manner that facilitates comparison between countries. The tax variables included in the analysis are:

- Corporate income tax;
- Rate of tax including tax holidays, if any;
- Loss-carry-forward provisions;
- Capital allowances, investment allowances and investment credits;
- Tax on dividends;
- Customs import duties and excise duties on business inputs.

VAT and sales tax are not considered in this analysis.

Financial models of project investment and financing, revenues and expenses are utilized for a hypothetical business in each sector. These are based on typical costs and revenues experienced in such businesses in a developing economy. The business models cover a selected business within each sector.

The fiscal regime in Rwanda and the chosen comparator countries for each sector is applied to the standard business model for each sector over 10 years beginning with the initial investment. The financial models calculate net cash flow to the investor, assuming that the company pays out all residual profits after tax (100 per cent dividend pay out) and that the investor gains the residual value of the company, which is sold after 10 years for an amount equal to its balance sheet value.

The impact of the fiscal regime is presented as the Present value of tax (PV tax per cent). PV tax per cent is the total of taxes and duties collected by government over the 10 years as a percentage of the project cash flow pre-tax and post-finance where both cash flows are discounted to a present value at a rate of 10 per cent per annum. PV tax per cent thus measures how much of an investor's potential project return is taken by the Government in taxes and duties. The higher the PV tax per cent, the more the fiscal regime burdens investors and reduces the incentive to invest.

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