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Investment Policy Review

Rwanda

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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 progess 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).

1. 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.

1. 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 a 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 interest 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 inititatives 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