United Nations Conference on Trade and Development

Investment Policy Review
Rwanda

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I. ECONOMIC STRUCTURE AND FDI IMPACT

Rwanda is one of the poorest countries in the world[1] 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.

1. Output structure and FDI

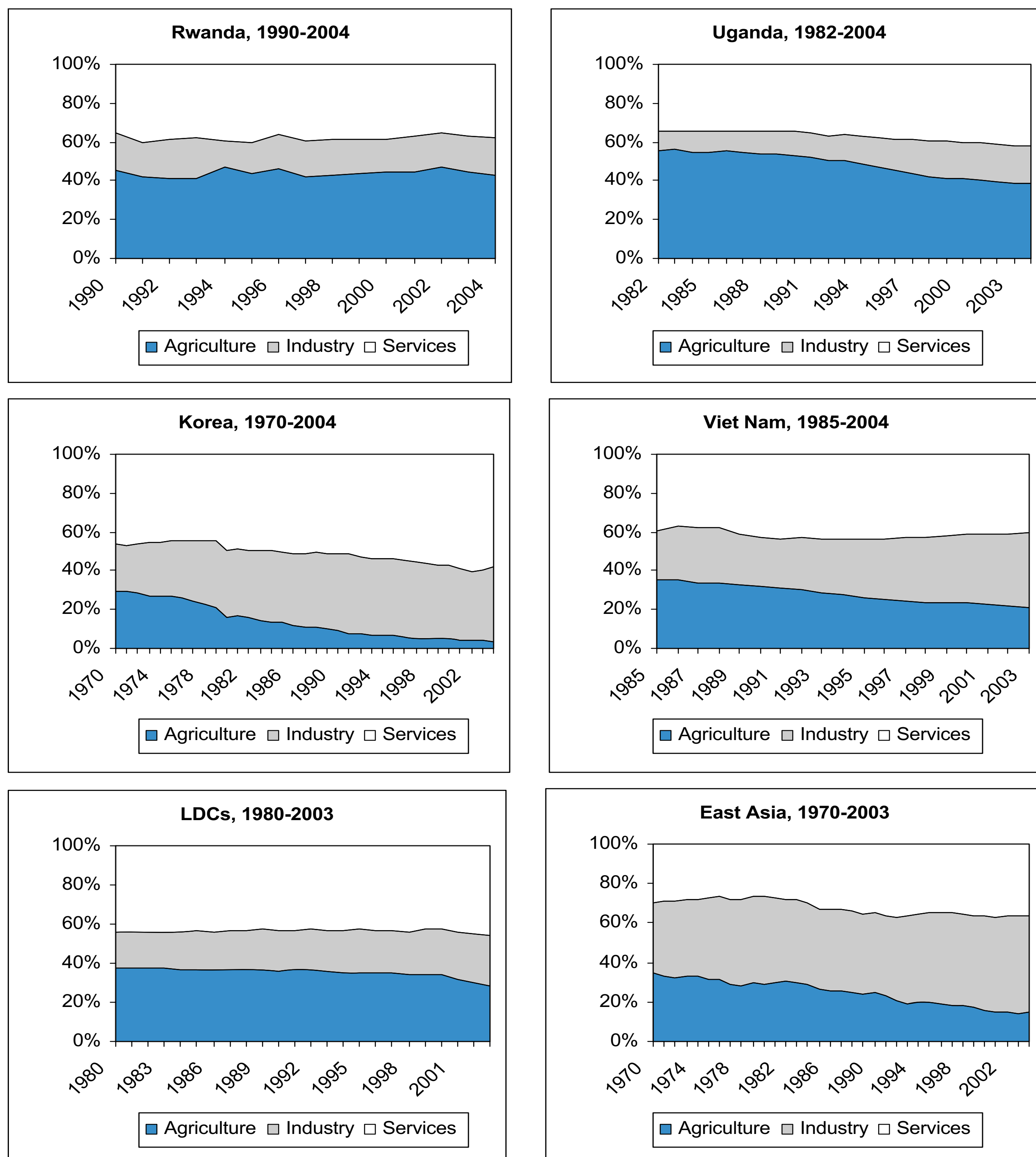
The Rwandan economy has undergone little transformation over the past four decades. The share of agriculture in GDP has hovered around 44 per cent since the 1990s, similar to what it was in the early post-independence years (figure I.1). Similarly, the shares of industry and the services sector have 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.

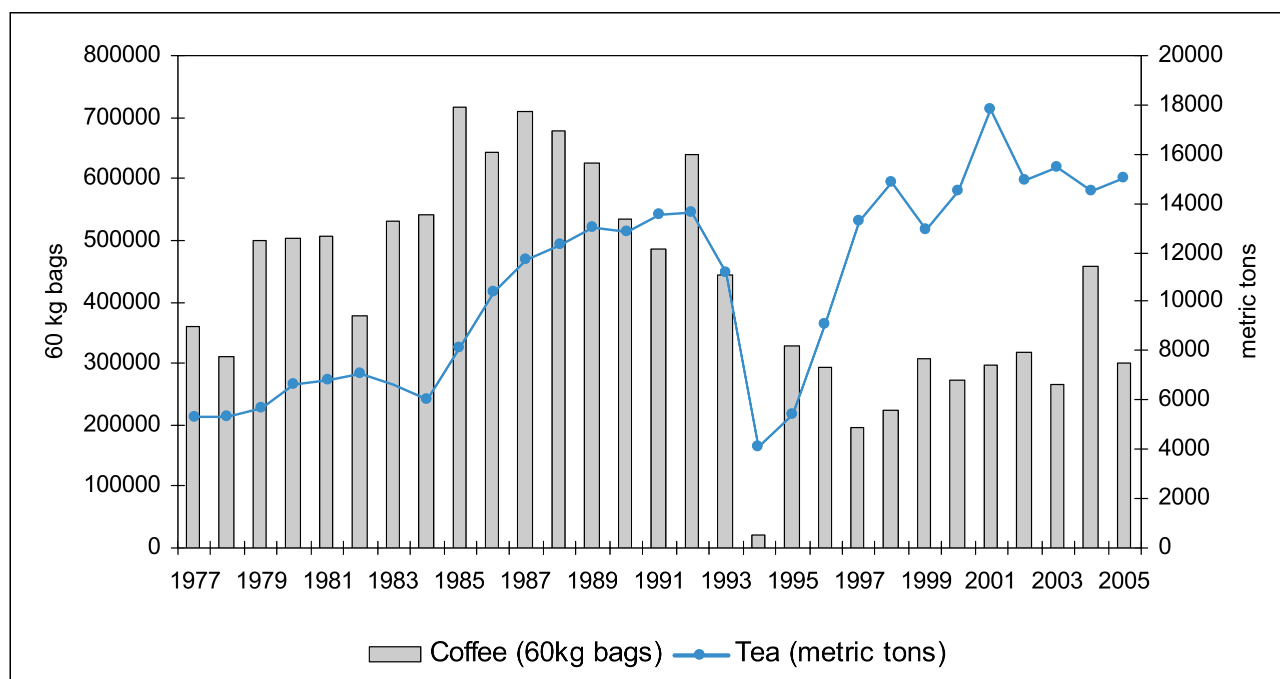
The industrial sector has evolved little over the past three or four decades. It has not only remained small, but is also undiversified and unsophisticated and has remained on the fringes of global changes in manufacturing (in terms of technologies, modes and organization of production, management, etc). 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.

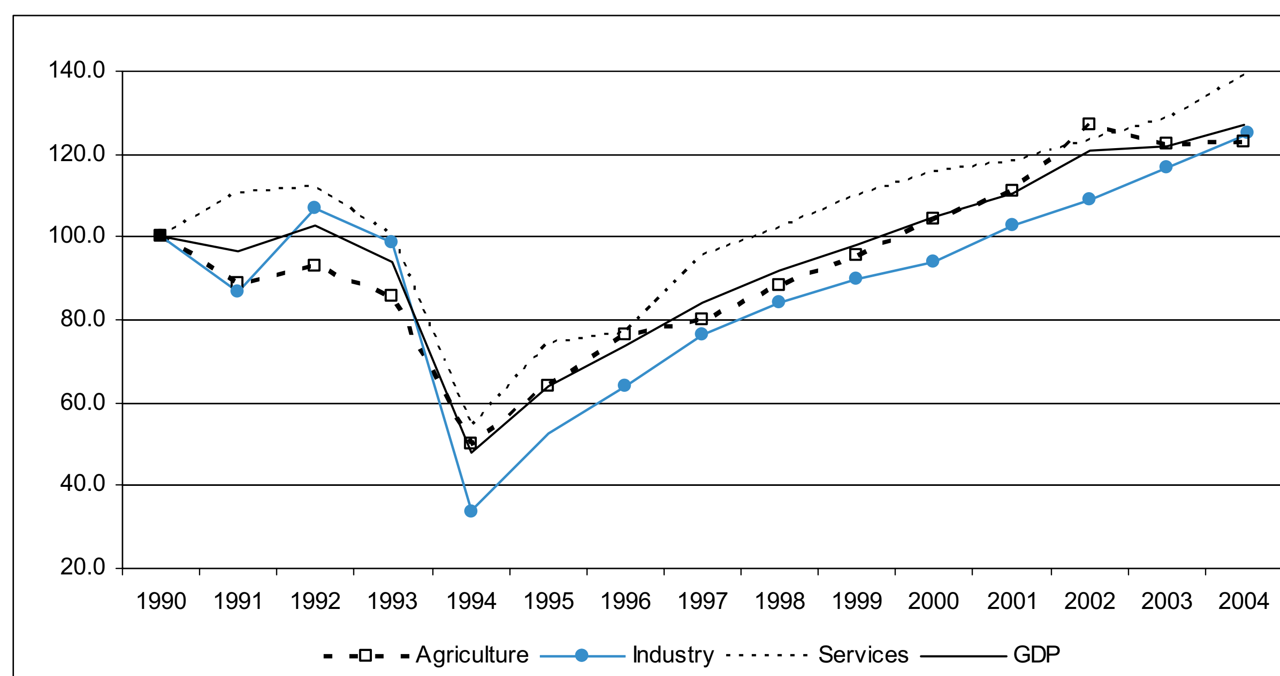
2. 1994 and structural reforms

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' Millenium 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 development[3] and challenges for the decades to come (box I.2).

Table I.1. Main targets of Vision 2020 and the Millenium 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

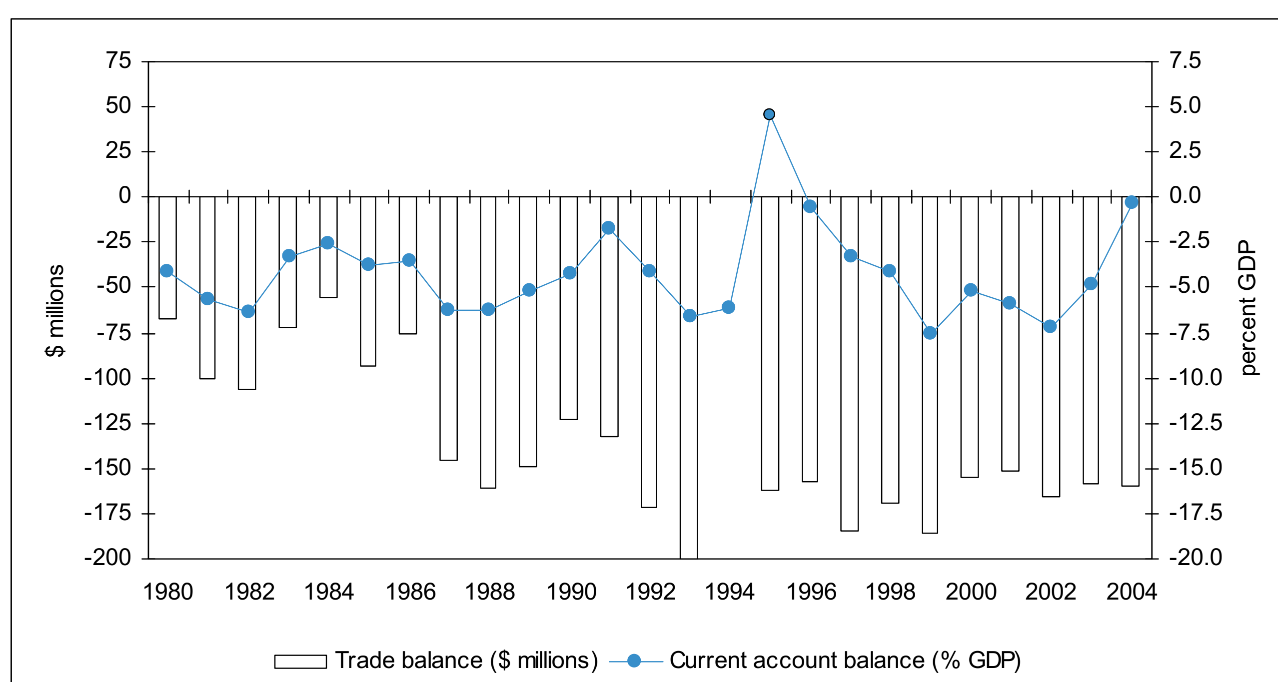
Source: OECD, CRS database.

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.

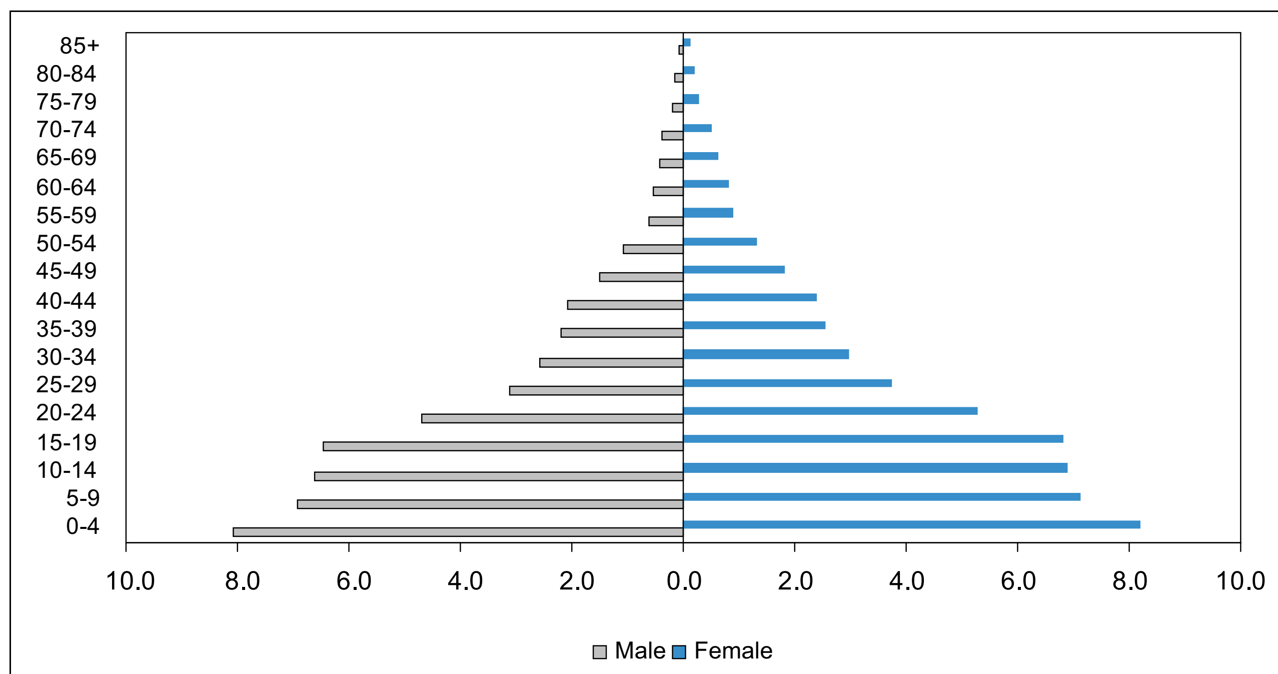
[2] Defined as the probability of dying between the age of 15 and 60, if subject to current age-specific mortality rates.

[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 study[7] 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

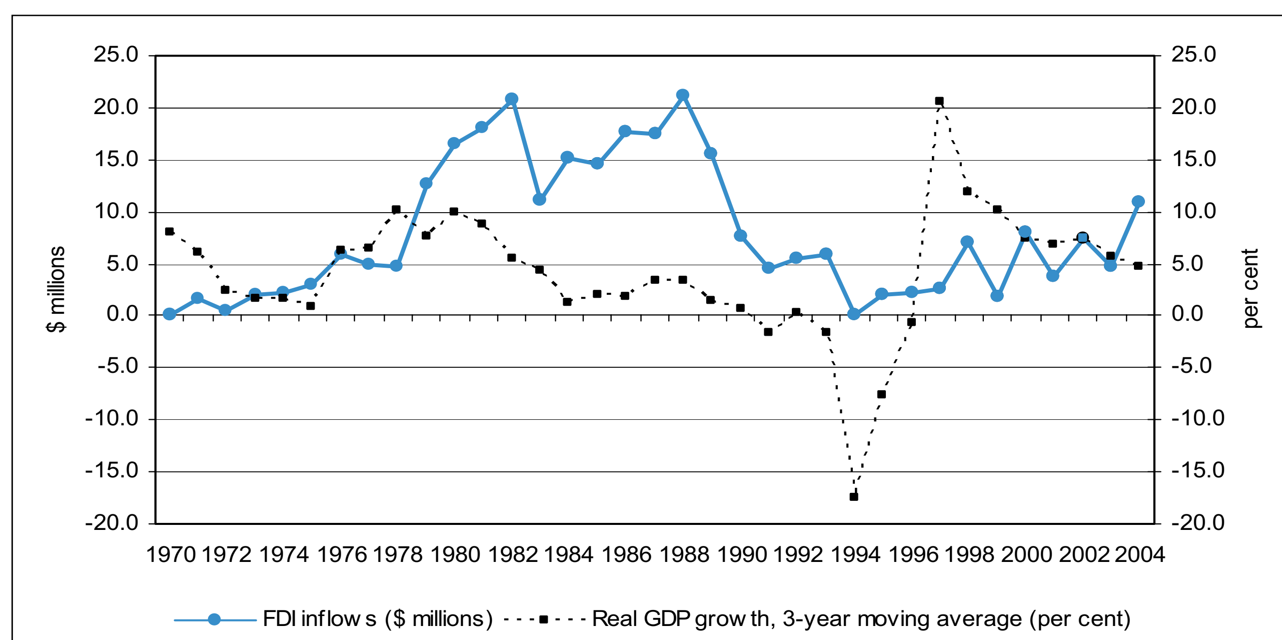
1. FDI size and growth

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 Milles 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

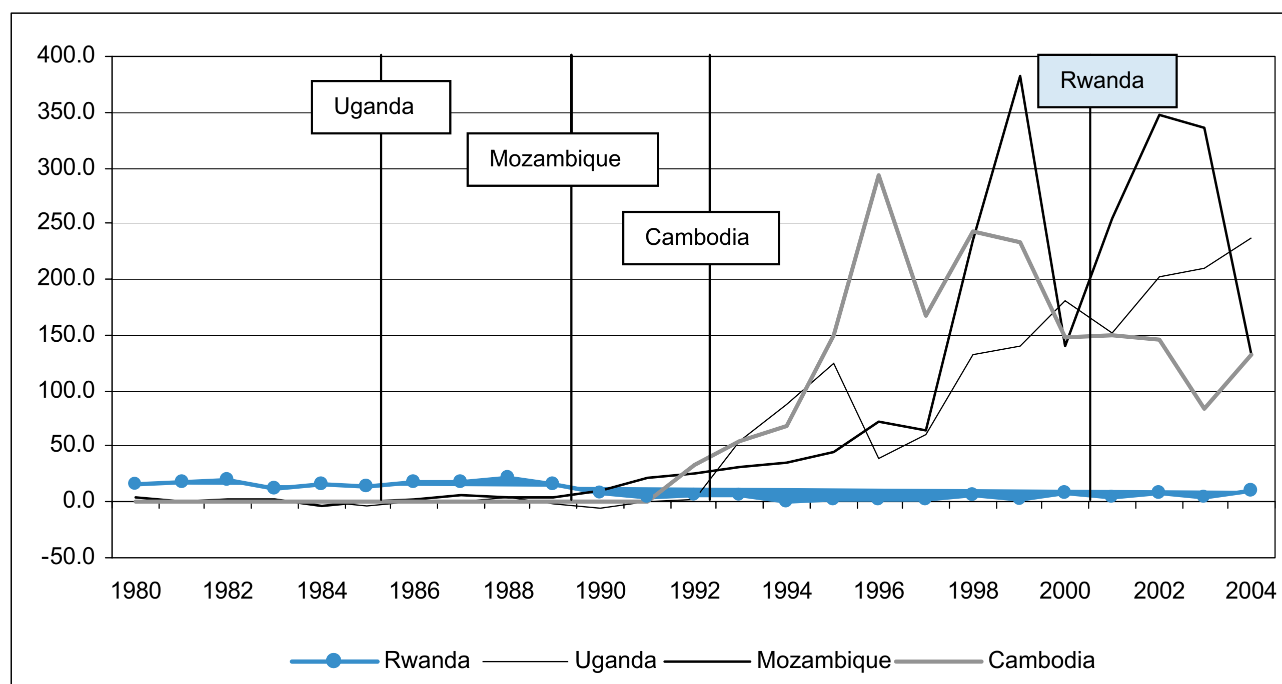
[8] Fortis Group decided to withdraw from Belgolaise in 2005 as part of a company-wide strategy. Fortis failed to identify a suitable group to take over the whole Belgolaise network (comprising banks in 10 countries in Africa) in a single deal and decided to liquidate its activities or integrate them 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 capita ($)				Per $1000 GDP ($)				Percentage of gross fixed capital formation				Per capita ($)	Percentage of GDP
	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	1986-1990	1991-1995	1996-2000	2001-2004	2004	2004
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

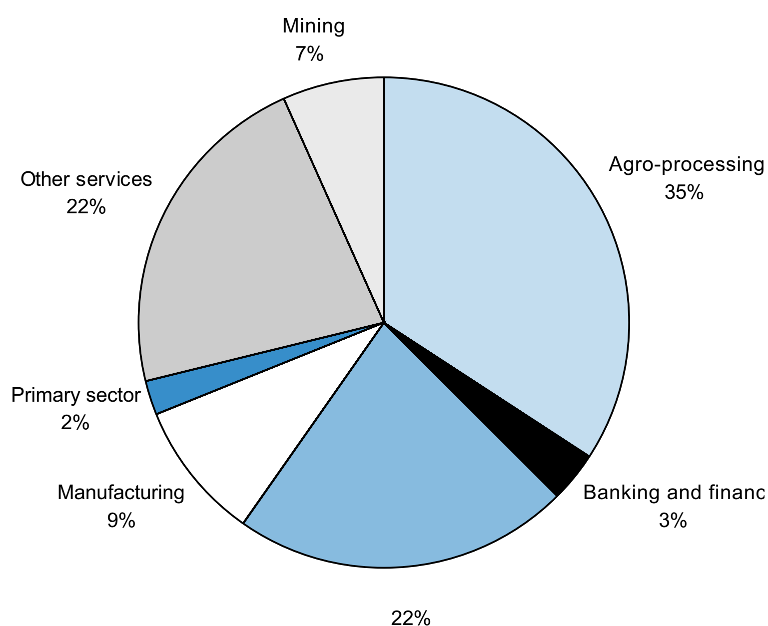
Source: UNCTAD FDI/TNC Database (WIR 2005)

2. Distribution by sector and industry

Foreign investment projects[13] 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 services[14] (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.

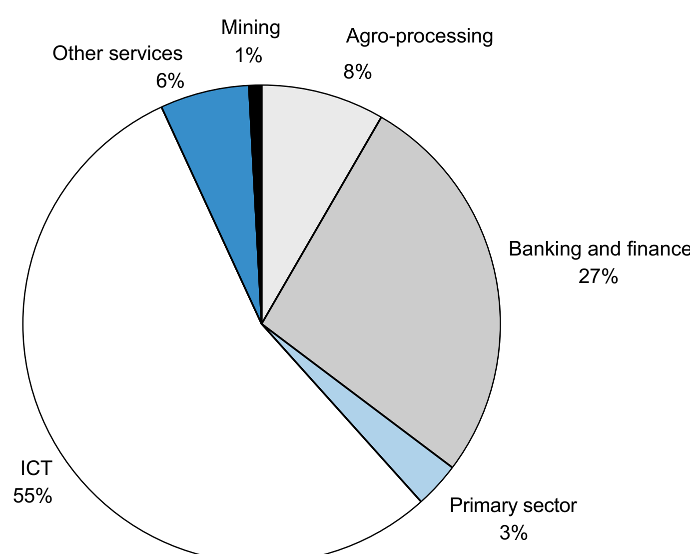
[13] Including operational and non-operational projects.

[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 sales[15] 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 Khazäna 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 Khazäna 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.

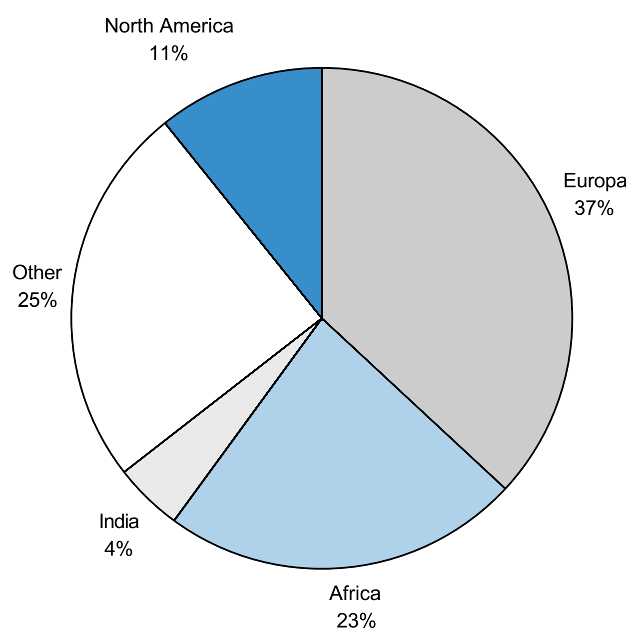
Source: investor interviews.

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.