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**Rwanda**



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### 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,<sup>58</sup> 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.<sup>59</sup> 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

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

<sup>59</sup> 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”,<sup>60</sup> or that “the country will (...) increase the flow of private capital, particularly direct foreign investment”.<sup>61</sup> 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).

<sup>60</sup> Poverty Reduction Strategy Paper, p. 65.

<sup>61</sup> 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.<sup>62</sup>

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.

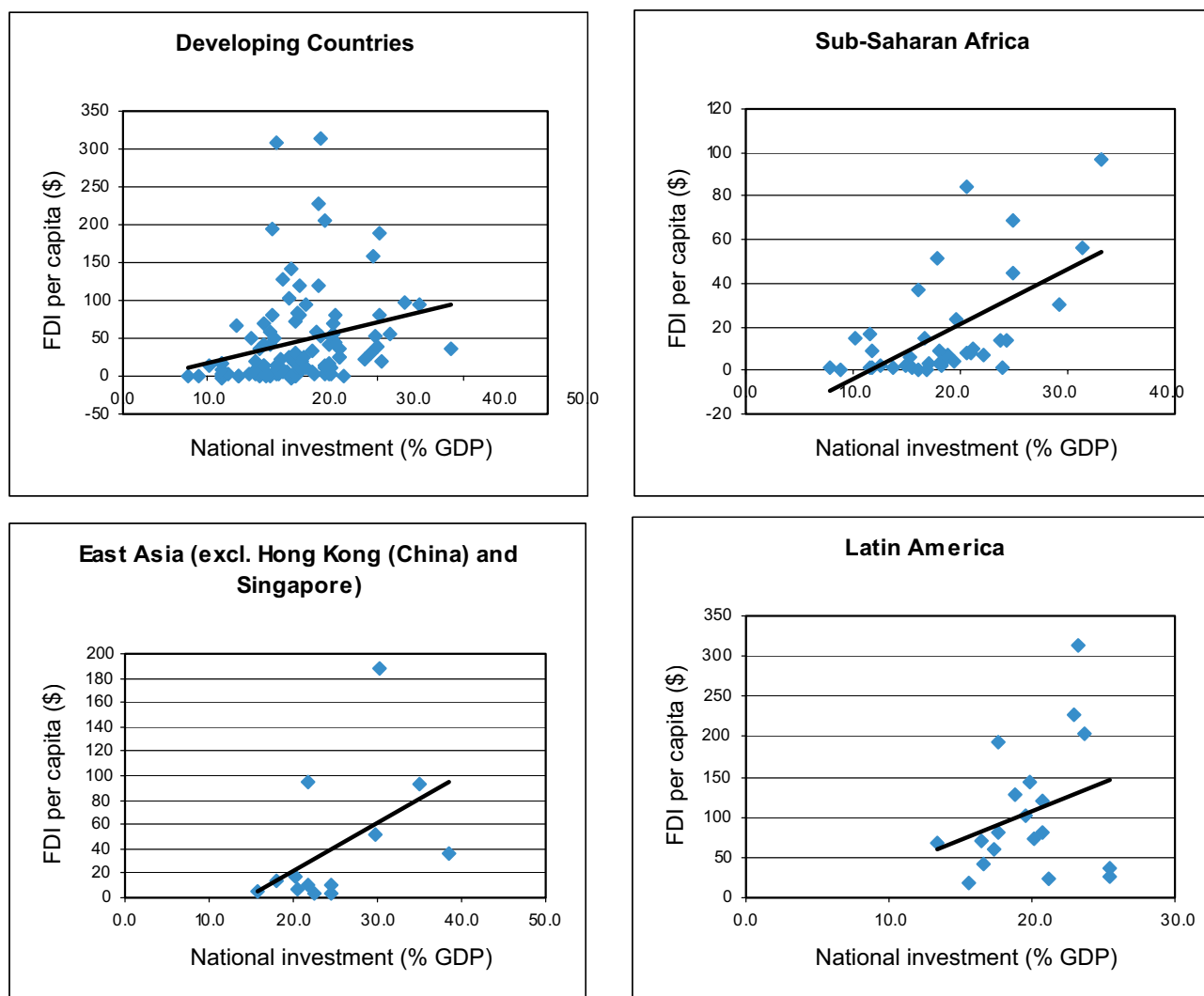
This correlation indicates that foreign investors are more attracted by economies where local investment itself is dynamic, and that FDI *complements* national investment more than substituting for it or competing with it. While FDI brings specific benefits to an economy, it is illusory for any country to expect it to substitute for a lack of national investment.<sup>63</sup> 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.

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

<sup>63</sup> 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) <sup>1</sup>	16.9	24.5	13.6	14.2	30.2

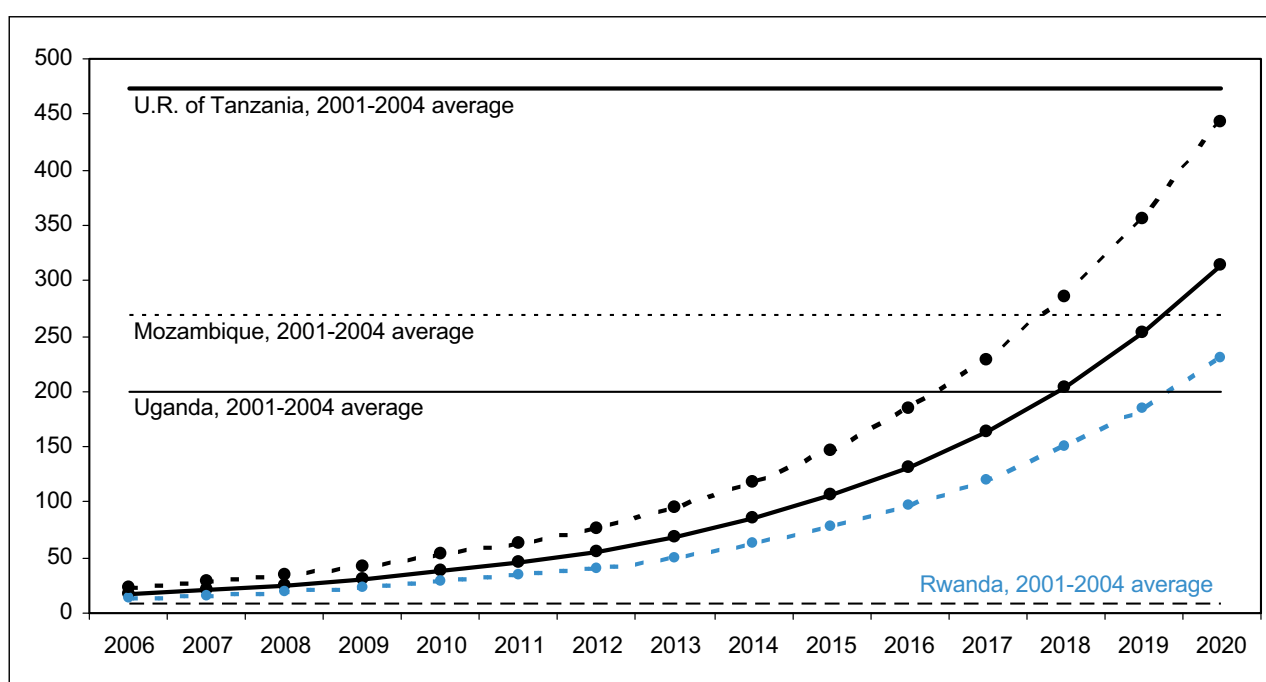
<sup>1</sup> Domestic investment, excluding FDI.

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 cent<sup>64</sup> 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.<sup>65</sup> 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

<sup>64</sup> Assuming real GDP growth of 8 per cent along the lines of Vision 2020.

<sup>65</sup> 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 Fund<sup>66</sup> 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

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<sup>66</sup> The concessional lending arm of the African Development Bank.

transported on this new railroad,<sup>67</sup> 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 11<sup>th</sup> highest ratio among 157 countries,<sup>68</sup> 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).

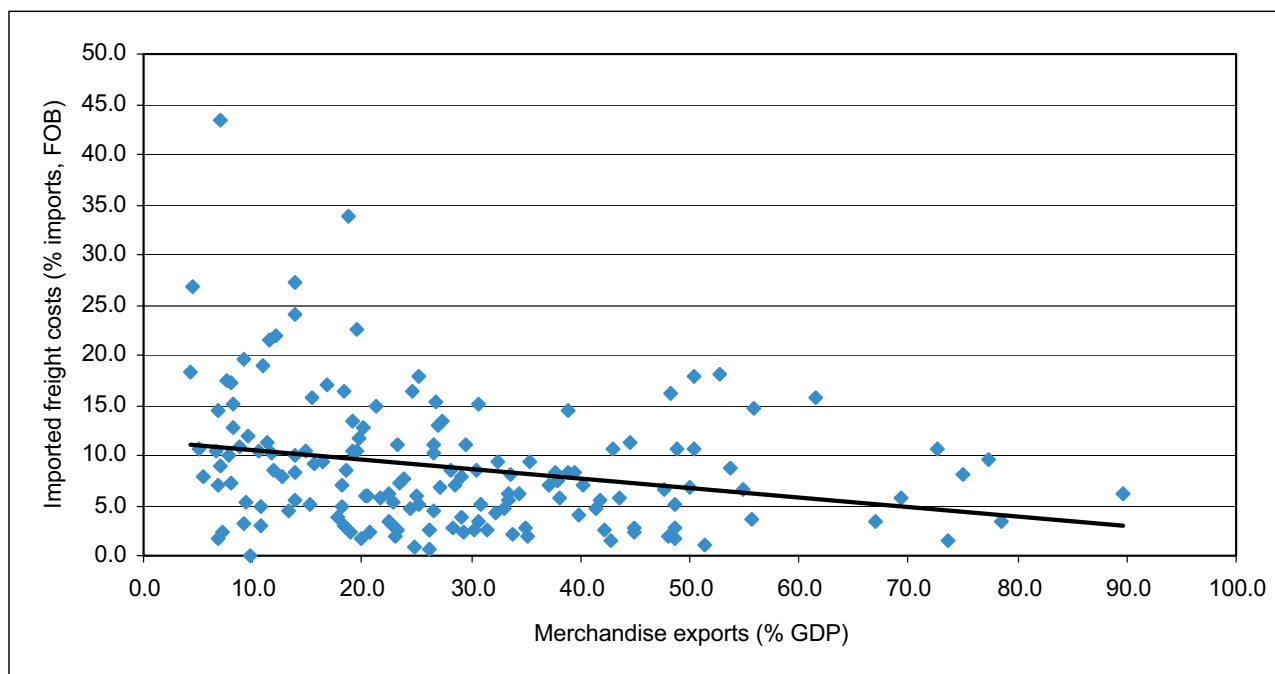
Such ratios imply that producers located in low transport cost countries enjoy a significant competitive edge over countries like Rwanda, which can amount to more than 10 per cent of the value of the good. When the cost of imported inputs and other advantages such as timeliness of delivery are factored 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).

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

<sup>68</sup> 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 149<sup>th</sup> economy in the world,<sup>69</sup> 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 103<sup>rd</sup> place in the 2004 ranking, behind countries as Ghana, Botswana, the United Republic of Tanzania, Cameroon, Kenya, the Dominican Republic or Costa Rica.<sup>70</sup>

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

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

<sup>70</sup> 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 <sup>2</sup> )	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 <sup>1</sup>	3.1	2.1	4.5	2.5	2.9
<i>Doing Business</i> indicators: <sup>2</sup>					
Procedures for licences (number)	17	11	18	26	19
Difficulty of hiring index <sup>3</sup>	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

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

<sup>2</sup> World Bank (2005). *Doing Business*.

<sup>3</sup> 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.<sup>71</sup> It has also applied for membership of the EAC<sup>72</sup> and SADC.<sup>73</sup> 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

<sup>71</sup> 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.

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

<sup>73</sup> 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.<sup>74</sup> 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.

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<sup>74</sup> 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.<sup>75</sup> 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.

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<sup>75</sup> 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,<sup>76</sup> 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

<sup>76</sup> 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.<sup>77</sup> 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.

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<sup>77</sup> 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 Lacs<sup>78</sup> (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

<sup>78</sup> 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:

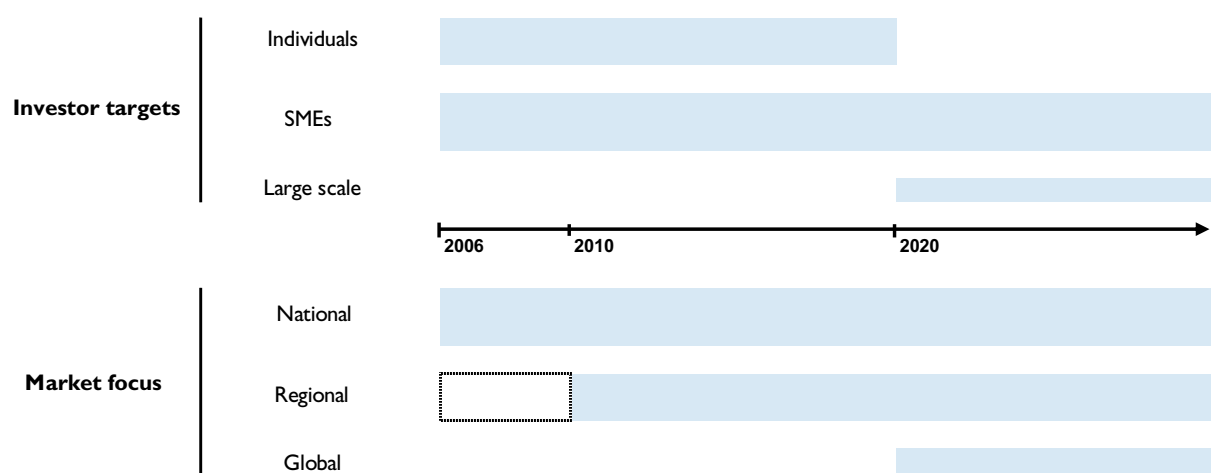
- Individuals from the region and from the Diaspora;
- Small- and medium-scale enterprises<sup>79</sup> (SMEs), mostly from the region, and to a lesser extent from beyond.

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.<sup>80</sup>

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

<sup>80</sup> 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 exporters<sup>81</sup> 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.

<sup>81</sup> 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**

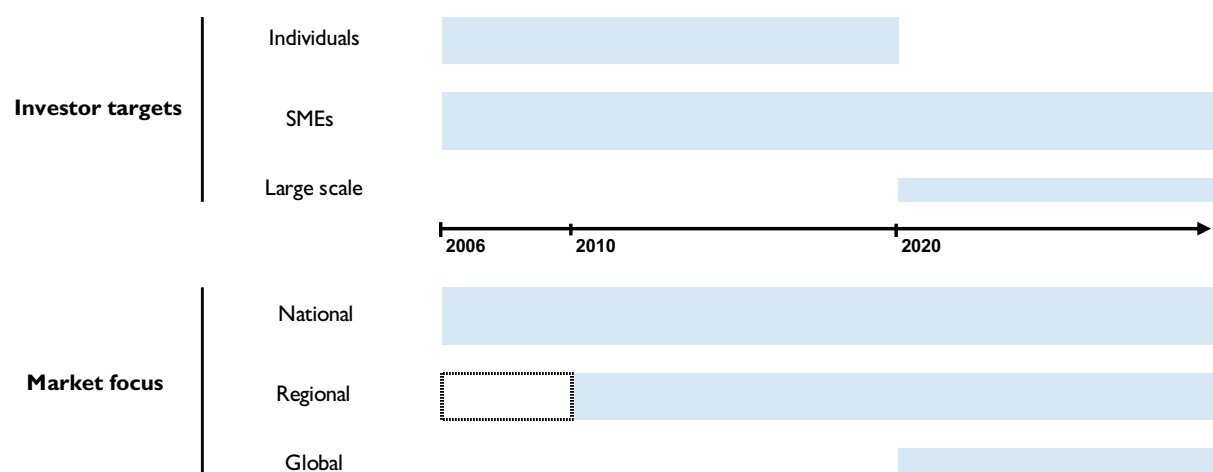
Although foreign investment in manufacturing is likely to focus on the domestic market at first, it could – and should – be used as a stepping stone towards exporting to the region. Given the long lead times in negotiating trade agreements, it is important that Rwanda secure optimal market access to 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 sector<sup>82</sup> 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.<sup>83</sup> 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

<sup>82</sup> ICT, tourism and financial services are considered separately below.

<sup>83</sup> 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.<sup>84</sup> 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;<sup>85</sup> 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 parks<sup>86</sup> started falling a few years before the genocide with the political and military instability

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<sup>84</sup> 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.

<sup>85</sup> 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.

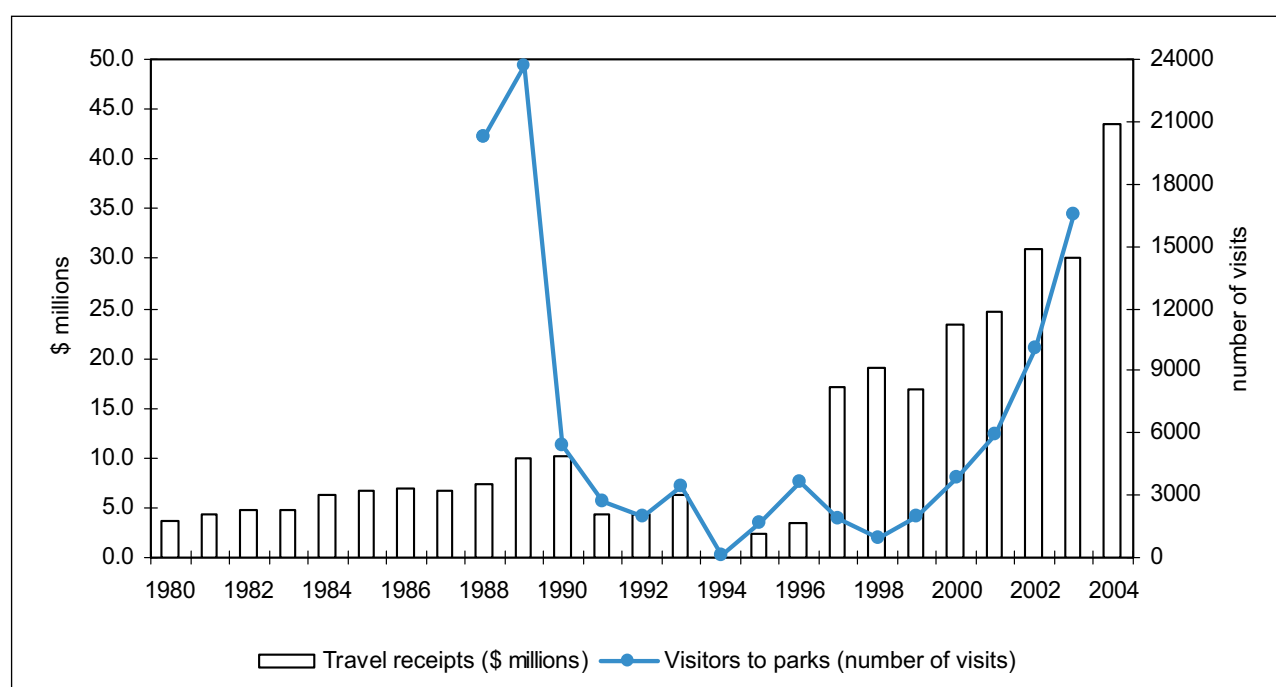
<sup>86</sup> Rwanda has three national parks: (1) the Parc National des Volcans, which is the home of the mountain gorillas; (2) the Nyungwe Forest National Park, a mountain forest with 13 species of primates and almost 300 bird species; and (3) the Akagera National Park, a typical savannah park, which 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 services<sup>87</sup> 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.

<sup>87</sup> 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.

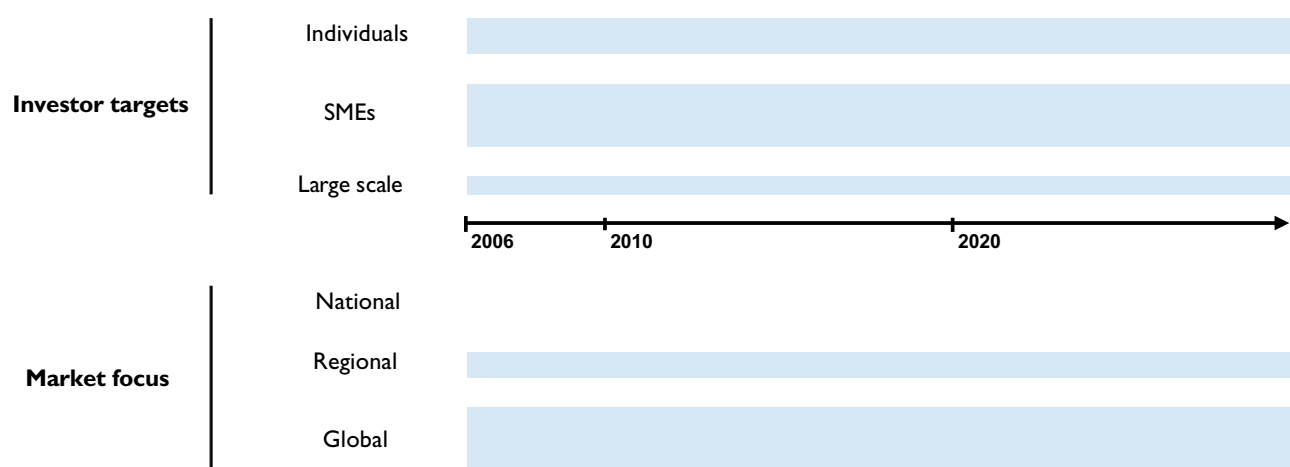
Attracting backpackers, however, would require that they at least have a chance at visiting Rwanda’s main attraction, the mountain gorillas. At the current price of \$375 per permit, most backpackers would be priced out of the market. It may thus be advisable to make a limited number of permits available 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.

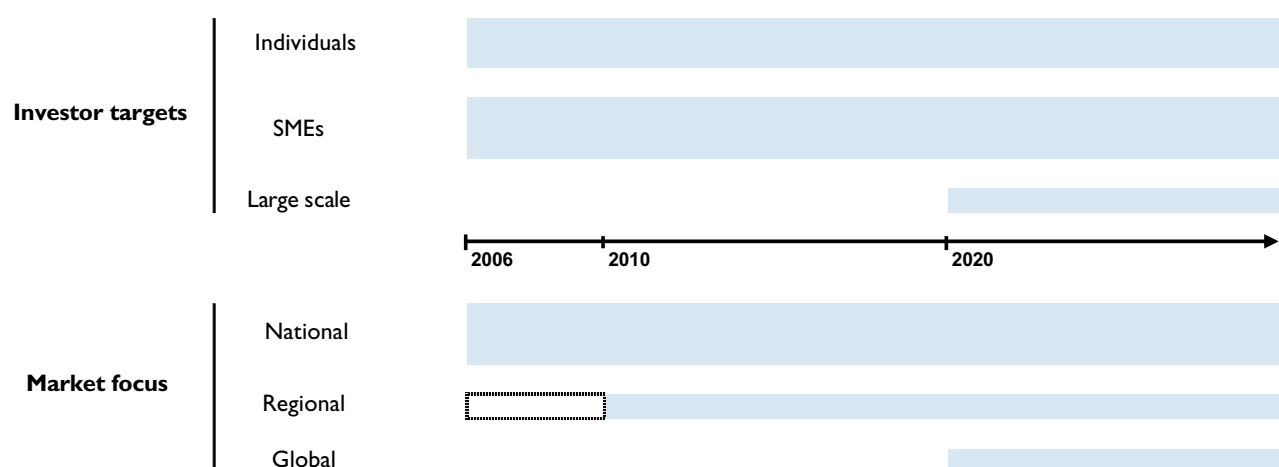
Most importantly the IT sector strategy recognizes and proposes solutions to key constraints in the development of this sector and the attraction of FDI. These constraints are quite similar in nature to those facing other sectors:

- 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).<sup>88</sup> 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).

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<sup>88</sup> 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.<sup>89</sup> 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.

<sup>89</sup> 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;<sup>90</sup>
- 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

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<sup>90</sup> 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,<sup>91</sup> 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.

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<sup>91</sup> 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:

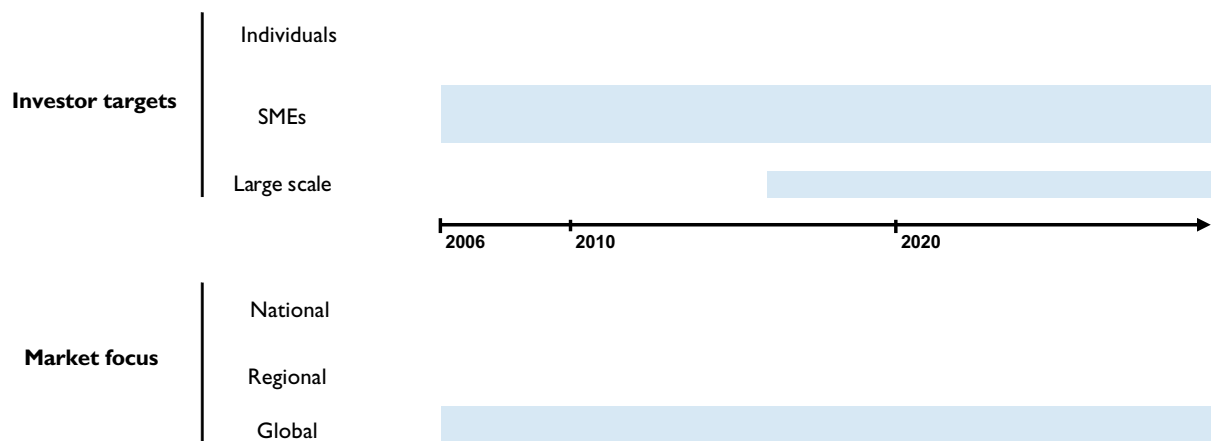
- The preparation of a new mining law and regulatory framework for the mining sector (chapter II);
- The improvement of the geological survey and centralization/digitization of all available data, with donor support;
- The privatization of Redemi's concessions.

### 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.<sup>92</sup> 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.

<sup>92</sup> 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).<sup>93</sup> 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

<sup>93</sup> 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.