

RWANDA
DIAGNOSTIC TRADE INTEGRATION STUDY
CONCEPT NOTE¹

I. Introduction and Background

1. This Concept Note discusses the issues to be considered in the proposed Rwanda Diagnostic Trade Integration Study (DTIS), which is being prepared under the Integrated Framework for Trade Related Technical Assistance to Least Developed Countries in response to a request from the Government of Rwanda.² To build the foundation for accelerated growth in Rwanda, the ultimate objective of the proposed study is to enhance the integration of Rwanda's economy into regional and global markets, through increased production and exports of Rwanda's traditional and non-traditional exports. The Government of Rwanda, with international assistance, has already drawn up a strategy to deal with many of the issues discussed in this Concept Note (there are comprehensive strategies for the coffee, tea and tourism sectors and a definition of a broad export promotion strategy), but there has not been a careful analysis of the key constraints that may compromise the success of these initiatives in stimulating trade, growth and poverty reduction. The proposed DTIS is, therefore, aimed at: (i) analyzing key constraints to expansion of trade in Rwanda, and (ii) providing a coherent and comprehensive view of the extent to which current and planned initiatives will come together to provide a stable environment in which trade can play a dominant role in sustaining growth at levels which generate substantial reductions in poverty. The IF will provide a vehicle for the delivery of the trade-related technical assistance requirements that are identified in the study.

2. Rwanda has made remarkable transformation since 1994, from the genocide to peace and development. A broad economic reform agenda was initiated in 1995 and notable progress has been made in establishing the rule of law and in rebuilding the economy. The economic agenda included macroeconomic stabilization, the establishment of new economic and financial institutions, the privatization of state enterprises, the development of human resource capacity, and repair of infrastructure. Building on this reform agenda ambitious targets have been set for growth and poverty reduction in the government's Vision 2020 and in the Poverty Reduction Strategy Paper (PRSP), which was completed in 2002 and endorsed by the executive boards of the World Bank and the IMF. The government has defined a vision of raising income per head to \$900 by 2020 whilst under the baseline PRSP growth scenario (of 5.5 per cent from 2005 to 2016) the share of the population in poverty will decline from 60.3 per cent to 32.5 per cent. Through extensive and broad based national consultations, six following broad areas have been identified in the PRSP: rural development and agricultural transformation; human development; economic infrastructure; governance; private sector development; and institutional capacity building

¹ Revised 12 November 2004.

² The IF is a multi-agency, multi-donor program established to promote the integration of the least developed countries into the global economy. The participating agencies are the IMF, the ITC, UNCTAD, UNDP, the World Bank and the WTO. For additional details see <http://www.integratedframework.org/>.

3. As noted by the IMF³, the Rwandan economy is nearing a turning point. Having established the key elements of a market economy, and with macroeconomic stability within reach, there is now a window for improving economic productivity, generating employment and strengthening export performance. Failing this, Rwanda risks moving to a slow and, possibly, unsustainable growth trajectory.

4. Although not explicitly mentioned in the PRSP, trade must play a key role in achieving the objectives concerning growth and poverty reduction. At present annual exports per capita in Rwanda amount to just \$18 compared to an average of \$145 in sub-Saharan Africa. As is recognized in the proposed export promotion strategy⁴, there is considerable scope, and indeed a necessity, for increased exports. This in turn will require that producers are able to effectively source low-cost inputs from the global market.

5. Rwanda is an agricultural country with mostly subsistence agriculture and two main cash crops - coffee and tea - which are the major export items.⁵ In the short-term the reinforcement of these traditional export sectors through commercialization will be the key to poverty reduction. In the medium term the strategy is to diversify both within existing sectors towards higher value products and to broaden the range of exported goods and services. While there have been substantial advances in other areas of the economy, the agricultural growth strategy remains under review, and action on the export promotion strategy is well behind schedule. In the absence of an effective agricultural policy and implementation of a strategy for strengthening export performance the prospects for economic growth and external sustainability are poor. These initiatives need to be assessed in a broader trade context, since, for example, the gains from rural development will be severely limited and there will be little export diversification whilst significant impediments to trade remain.

6. The objective of this DTIS will be to provide the necessary comprehensive and encompassing assessment of the extent to which current and proposed initiatives to develop the economy of Rwanda will indeed effectively address the main barriers that currently constrain trade, and to define the necessary additional actions that will be required for international trade to underpin sustained growth in Rwanda and deliver the ambitious targets for poverty reduction. An important element of the report will be to carefully demonstrate the synergies between different policy issues and the need for a comprehensive forward looking strategy on trade. A key output from the DTIS will be a highly focused action matrix which will provide a prioritized plan of *realistic* policy measures, investment and technical assistance that are needed to address the key constraints to trade. The findings of DTIS will be discussed at a national workshop, which will bring together all stakeholders, to refine and act upon the priorities identified. The DTIS will provide the mechanism by which priorities with regard to trade are integrated into development strategies through the PRSP, an update to which will be made during 2005. The action matrix of the DTIS will clearly identify actions to enhance

³ AIDE-MEMOIRE, 2004 Article IV Consultation, July 2004

⁴ Cabinet Memorandum "Rwanda's Export Promotion Policy and Strategy Paper: Short-Term Actions and Medium Term Policy Considerations", August 2004

⁵ accounting for around 60 per cent of total exports in recent years.

existing export sectors, where there is a significant potential to have a more immediate impact on poverty, from initiatives towards export diversification, whose impact on poverty will materialize over the medium to longer term.

7. Section 2 of this Concept Note provides background on the Rwandan socio-economic context and recent economic developments. Section 3 sketches out the main trade constraints to be addressed in the proposed diagnostic study. Section 4 summarizes the approach and organization of the task.

2. Socio-economic context

Overview:

8. Rwanda is a small land-locked country with a population of 8.4 million. The country continues to face complex socio-economic problems stemming from the 1994 genocide and preceding conflicts. Income per capita, at \$230 in 2003, is still much lower than the \$370 achieved in 1990 and Rwanda remains one of the poorest countries in the world. Sixty percent of households live below the poverty line compared to 40 percent in 1985. The population density of about 350 per km² is one of the top ten in the world. Agriculture is the primary activity for the 90 percent of the population living in the rural areas but Rwanda ran out of new arable land almost 20 years ago and agricultural productivity has not seen any improvement. Agriculture is estimated to account for 41 percent of GDP. Services account for 38 percent, consisting of wholesale and resale trade in various products, transportation, and public administration. Industry accounts for 21 percent of GDP, with roughly half of this share attributed to manufacturing and the other half to construction.

9. Social indicators still remain low, with life expectancy of 49 years in 2000. The incidence of HIV/AIDS is high, at about 13 percent. Rwanda has taken huge strides toward improving social services, reducing gender disparities, and initiating a serious effort to attack HIV/AIDS. Health indicators have improved steadily and are reaching pre-genocide levels. At all levels of education, enrollment rates have increased, with net and gross enrollments surpassing pre-genocide levels and primary school enrollment of girls on a par with that of boys.

10. Rwanda is still addressing the legacy of the 1994 genocide in which close to one million people were killed, two million people were driven into exile, over a hundred thousand people were put in prison, and thousands of people were handicapped, physically and mentally. Following the genocide, however, with human capital, economic infrastructure, and government and private institutions in ruin, Rwanda undertook an extraordinary national regeneration. Almost all refugees have returned and the reconciliation process has progressed significantly.

11. An ambitious program of socio-political reforms, aimed at improving justice and governance and empowering the population through decentralization and democratization, and the resolution of cases against the genocide-accused (GACACA), is being implemented in parallel with the economic reforms. A new constitution was

adopted by popular referendum in May 2003, followed by presidential and legislative elections during August-October, 2003.

12. While impressive progress has been made, significant challenges remain. Regional instability remains a threat to peace and development. Rwanda is also likely to have serious difficulty in attaining the millennium development goals (MDGs).

Recent Economic Developments:

13. Despite many structural constraints, continued improvement in security after the genocide and strong government commitment to reforms led to strong economic growth until 2002. The period from 1995-2002 was one of systematically high growth, ranging from an average annual growth rate of 11.4 per cent during 1996-98 to 8.1 per cent during 2000-02. While agriculture and construction were the main sources of growth, by end 2003, neither manufacturing nor commerce had regained its 1993 level. This growth, coupled with low and stable inflation, made Rwanda one of the best performers in sub-Saharan Africa. Through improved tax policy and administration, revenue performance reached 13.5 percent of GDP in 2003, up from 9.7 percent in 2000. The fiscal deficit (before grants) remained very high at 10.5 per cent partly due to high transitional and social spending, consistent with the PRSP priorities.

14. Economic performance since 2003 has been faltering, reflecting the immediate impact of a drought but also the outcome of low investment in the energy sector and weak planning with regard to energy supply and resource use. Failed rains during 2002-03 led to a decline in agricultural output. GDP grew at a much lower rate than in previous years. Higher net credit to the government from the banking system and increased bank lending to private businesses led to a rapid expansion in the money supply. Money expansion contributed to significant depreciation of the Rwanda franc in 2003. Inflation increased steadily during 2003 and 2004 due to the decline in agricultural production and depreciation of the franc. Based on preliminary data, real GDP growth in 2004 is expected to be significantly lower than the projected 6 percent, which is mainly due to drought, the energy crisis and significant slow down in construction activity.

15. International competitiveness and creating a good business environment are essential for trade. The real exchange rate has depreciated in recent years, especially in 2003. The exchange rate is market determined with the Central Bank (NBR) occasionally intervening to smooth out any disturbances. The quality of business regulation and related institutions have improved in the past few years. The World Bank's business climate survey⁶, however, noted that Rwanda ranks near the bottom in the region for a range of issues related to creating and closing a business and in getting a bank credit. For example, for the indicators such as the time to start a business (days) and cost to start a business, Rwanda ranks behind Uganda, Ethiopia and Tanzania.

16. The recovery of Rwanda's trade has proved challenging. After a strong improvement in the world market prices for coffee during 1995-96, the collapse of coffee prices in 1997 was followed by substantial export price declines, leading to a 42 percent

⁶ World Bank (2004) "Doing Business in 2004 Rwanda Country Profile".

(cumulative) deterioration in Rwanda's external terms-of-trade during 1995-2002. Coffee production declined steadily due to the destruction of human and physical capital and in recent years from lower coffee prices. The total volume of exports in 2003 was roughly one-third of pre-genocide volumes. In contrast, tea production has increased steadily. Following a short boom in prices and volumes in (2000-01), the export value of coltan declined from \$41 million in 2001 to a projected \$4 million in 2004. In 2003, merchandise exports were only about \$63 million, which leads to one of the lowest merchandise export-to-GDP ratios in the world (4 percent in 2003). Even when services exports (tourism) are taken into account the contribution of exports to GDP remains remarkably low. With the import bill relatively steady (at about 25 percent of GDP), exports earnings covered only a fraction of the import bill, leaving Rwanda critically dependent on external assistance. With the mainly donor financed import bill and the poor performance of exports, the current account deficit before grants reached 19.2 percent of GDP. Weak export performance contributed to a loss of foreign reserves of about \$35 million in 2003 and a significant increase in Rwanda's net present value (NPV) of external debt to export ratio, from 195 percent in 2002 to about 300 percent in 2003.

17. In all this highlights the critical need for enhanced trade performance to bolster macroeconomic performance, to allow for a redirection of the disbursement profile of external assistance and to directly contribute to development and poverty reduction. In this context, the following sections review the main constraints which are currently limiting trade in Rwanda. The discussion is based upon two preliminary missions to Rwanda that concentrated upon interviews with companies and relevant government officials. It is proposed that these issues will form the focus of attention in the DTIS and will be complemented by a number of sector specific studies, which will highlight the impact of these barriers on key activities.

3. The Key Constraints on Rwandan Trade

Transportation

18. Transport costs are of crucial importance to small land-locked countries such as Rwanda, determining the ability of exporters to access external markets and of importers to effectively source products from world markets. In Rwanda, air transport is crucial to the development of non-traditional exports such as horticulture and tourism and is also likely to be important in setting up a services sector based around ICT, as is envisaged in the Government's long-term vision.

19. Currently, Rwanda suffers from facing extremely high transport costs, amongst the highest in the world, with UNCTAD estimating that transport and insurance payments comprised 48.4 per cent of the value of exports in 1997, compared to an average of 14.1 per cent for land-locked countries and 17.2 per cent for least developed countries. This is reinforced by anecdotal evidence from traders: the cost of moving packaged agricultural products from Kigali to Mombasa is claimed to be twice the cost of the subsequent transport from Mombasa to Antwerp; the costs of importing palm oil from Malaysia is around \$65 per tonne for the Malaysia to Mombasa part of the route and then \$200 per tonne from Mombasa to Kigali. In addition to the direct costs of transportation, the length

and variability of transportation times entails that producers have to hold much higher inventories (one manufacturer reporting having to hold 6-8 months of raw material inventories entailing that \$2 million of cash flow was effectively blocked) .

20. High transport costs and uncertain delivery times have a number of implications for trade and for poverty reduction in Rwanda:

- They are a key factor limiting the returns to producers and, therefore, in influencing poverty. Rwanda is currently exporting homogeneous agricultural products where prices are typically set in auction. Thus, it is producers in Rwanda who have to bear the higher relative transport costs compared to producers in other, less transport-constrained countries.
- High transport costs raise the price of imports, with adverse impacts on the consumption of final products and on producers using imported intermediates.
- Transport costs have a major influence on the ability of Rwandan producers to compete in overseas markets. For a range of products exportation is not feasible under current transport conditions. Hence, high transport costs are a major barrier to export diversification.
- High transport costs limit the ability of Rwandan exporters to satisfy rules of origin and exploit available preferences in regional markets and in the European Union (EU) and United States (US). High transport costs entail a high price for imported inputs which makes it very difficult for local producers to satisfy value-added rules of origin and exploit the advantage of relatively low labour costs.

21. On top of the locational disadvantage, there are a range of barriers and constraints which further raise transport costs for Rwanda. Currently, producers in Rwanda have two possible routes to access sea ports – a northern corridor through Kampala to Mombasa (1800 km) and a central corridor to Dar-es-Salam (1500 km). Despite the longer distance, 80 per cent of traffic uses the northern corridor to Mombasa, due to insecurity and the poor quality of roads on the central corridor. A key issue is that rail transport is available on both routes but does not extend into Rwanda; on the northern corridor rail is available from Kampala (500 km from Kigali) and on the central corridor from Isaka (350 Km from Kigali). For many products rail offers the possibility of lower costs per tonne. A key issue relates to the reliability and quality of the rail services provided on both routes. Transport users attest to the unreliability of the rail services (with long delays at the port due to unavailability of wagons and locomotives – and subsequent storage charges) and are insufficiently secure for certain products.

22. Road costs are exacerbated by the prevalence of road blocks, insecurity and the number of weighbridges (which lack consistency), especially on the route to Mombasa, leading to a substantial number of additional payments along the route. Hence there are a number of key infrastructure and operational issues which need to be assessed to improve the availability, quality and efficiency of transport for exporters and importers. By the nature of its location, Rwanda will have to develop policy responses to these issues in

concert with neighbouring countries: which reinforces the need for regional approaches and institutions.

23. The northern corridor has been subject to substantial attention and resources, whilst the central corridor has been relatively ignored. Effective choice of transport route is often essential in providing land-locked countries with lower transport costs and reliable transport services.⁷ Hence, there is a need for review of the effectiveness of the northern corridor from the Rwandan perspective and an assessment of how to enhance the central corridor.

24. In addition to access to ports, there is also the issue of the cost and availability of internal transportation. The proportion of all-weather roads covering Rwanda is small. The quality of the existing road network is poor leading to high transport costs and uncompetitive markets, which in turn is detrimental to the commercialization of agriculture and to trade. Improved roads will expand markets, raise returns to producing cash crops and increase competitiveness of agricultural products. Isolation in rural areas is a factor leading to lower levels of consumption and poverty.

25. Therefore, a reduction in transport costs will be crucial to the attainment of objectives concerning trade, growth and poverty reduction. Lower transport costs would increase effective purchasing power in the domestic market and stimulate domestic output and exports. The, albeit limited, available evidence suggests a high degree of responsiveness of trade to reductions in transport costs, with an estimated elasticity in the region of three.

26. As part of the DTIS there will be a comprehensive analysis of transportation issues for Rwanda, which will link to similar work being undertaken in Tanzania and Kenya. Key issues to be addressed will include

- Measurement of transport costs at all stages of the product chain (from field to foreign market), identifying the key sources of delays and high costs.
- The impact of a proposed rail link to Kigali in contributing to facilitating expansion of existing exports and the exportation of more diversified exports in the medium term, relative to the impact of enhancing existing corridors, taking into account the impact of rising oil costs.
- An assessment of competition in the transport sector and the operation of the public transport enterprise (ONATRACOM) and the extent to which improvements in transport infrastructure and operating costs would actually be passed on the consumers and producers.
- An assessment of whether the air transport sector can play the role that is required to facilitate export diversification and the development of services based export activities.

⁷ Global Economic Prospects 2005, World Bank (2004).

This work for the DTIS will be undertaken in close cooperation with ongoing work to strengthen the northern corridor and to integrate Rwanda into the Northern Corridor Project.

Customs Clearance

27. Customs are a key issue affecting trade. Inefficient and/or corrupt customs and long delays at the border restrict trading opportunities. Significant progress has been made in improving customs clearance and introducing the transaction value method for valuation and additional improvements are expected as a computerized clearance system is fully implemented shortly. The traders contacted in the preliminary mission did not consider corruption amongst customs officials in Rwanda to be a major problem. Nevertheless, traders still report significant obstacles to trade arising from customs operations:

- The operation of the current Magerwa (bonded warehouse) system leads to additional costs and can lead to long delays in the release of goods. Imported goods are subject to a 4 per cent Magerwa or warehousing fee (three-fourths of which goes to central government revenues), which acts to raise the cost of imports. This fee is payable regardless of whether the goods are actually unloaded, for example, as in the case of oil products in tankers. There are a range of additional charges relating to documentation, handling, weighing and parking.
- Crossing multiple customs frontiers on the northern corridor can lead to substantial delays and often requires that customs agents are present at each post to ensure smooth passage of goods.
- Goods in transit to Rwanda face substantial delays at the port of entry in Kenya and Tanzania.
- Smuggling, mostly from neighboring countries, is causing substantial problems for domestic producers in Rwanda.

28. The DTIS will assess current customs and border processing/clearance procedures, identify compatibility with international best practices and identify areas for improvement with associated human and infrastructure requirements and technical assistance needs. Within this the study will assess the extent and potential for cross-border cooperation and rationalization. The DTIS will obtain, or analyse existing measures, of customs clearance times and delays at the border to allow for an assessment of the costs of existing practices and so provide an input into the analysis linking trade barriers to poverty that will be undertaken in the project. The DTIS will then proceed to provide a longer-term assessment of the capacity of customs in the light of the objectives to increase trade and diversify exports. This analysis will be undertaken in close cooperation with those preparing the proposed Rwanda Transport Sector Project and the Regional East Africa Trade and Transport Facilitation Project.

Energy and Water

29. Rwanda is currently enduring an energy crisis, with regular interruptions to supply. Due to drought conditions in the country for the past two years and low water levels in two lakes – Bulera and Ruhondo - where the hydro dam is located, supply of electricity has been badly effected. In addition to this, demand has been increasing at double digit

growth rates. Many business have been forced to invest in generators, from which the unit cost of electricity is about 3 times higher than that provided from the utility, Electrogaz. There are also additional costs in terms of the capital cost of the generator and maintenance. Producers unable to purchase generators have typically significantly curtailed output.

30. Whilst there are both short-term (additional diesel generators for Electrogaz) and long-term strategies (development of methane from Lake Kivu), it is important to recognize that both the increasing commercialization of agriculture and diversification into a broader range of products may increase the energy intensity of output. Electricity shortages and uncertainty over supply will weaken initiatives taken by the government to diversify the economy and reduce growth rates. Many industries and businesses already are running at reduced levels of capacity mainly because of severe power and water problems. Preliminary data show that significantly lower projected growth rate of GDP in 2004 is partly due to the electricity shortage.

31. The solution of using additional diesel generators will have implications for energy users in Rwanda, since there will be some pass-through of the additional costs from diesel generation to users in terms of a surcharge to the current electricity tariff. The precise implications of this for growth and trade need to be assessed. There is also the issue of the impact of importing additional quantities of oil on the balance of payments and the exchange rate.

32. The availability and cost of water is also crucial to the development of many agricultural and manufacturing industries and will also influence the perception of Rwanda as a place to do business and as a destination for tourists. Upgrading the quality of coffee revolves around the introduction of washing stations. Many packaged and processed agricultural products require large amounts of water. Several businesses reported that they were unable to effect plans to expand and to export in the absence of reliable water and energy supplies. The provision of water in urban areas is also linked to the energy issue, due to the energy needs of pumping stations.

Standards and Quality

33. The system of standards, quality assurance, accreditation and metrology and the way that it is implemented and enforced is crucial to competitiveness to sustained growth and to development. To participate in the global marketplace firms in developing countries must comply with standards and therefore must invest in compliance. If such a framework is to be effective in facilitating improvements in overseas market access whilst raising the quality of goods and services in the domestic market it is important that private companies and other interested stakeholders are able to fully participate. An initial prerequisite for higher levels of participation is an increase in awareness of the presence of standards, their nature and the benefits that arise from their use.

34. Rwanda has committed to introduce a modern system of standardization but is starting from an extremely low level of institutional and human capacity with very little awareness amongst producers of issues relating to quality and safety. For example, there

is only one firm in Rwanda (BRALIRWA, a brewery) which has been certified in compliance with the ISO 9000 standard on quality management. The Rwandan Bureau of Standards Bureau (RBS) was only recently created in 2002 and is in the very early stages of acquiring equipment and appointing qualified staff and starting to raise awareness. It has yet to receive substantial support from international donors in defining, developing and applying a coherent system of standardization. The availability of laboratory services for testing is severely limited such that actual and prospective exporters often have to incur the costs of sending products overseas for testing.

35. It is in this context that the strategy of enhancing the quality of existing export products and the diversification into a broader range of products must be assessed. In both cases the ability to consistently deliver the quality and satisfy the standards of overseas markets will be crucial in determining the capacity to raise exports. An effective institutional framework in Rwanda to raise quality and allow for the development of management systems which ensure compliance with standards will be necessary if objectives concerning growth of higher value and non-traditional agricultural exports are to be met.

36. In turn, studies of countries that have successfully diversified into products such as horticulture highlight the critical roles of investment in transportation and port/airport infrastructure, investment in research and advisory services, the transfer of technologies and skills, measures which facilitate investment in and access to land and a conducive investment environment.⁸ Hence, the system of standardization is one element in a broad climate that is necessary for successful export diversification. These studies also note the important synergies that can arise between horticulture and similar industries and complementary industries such as domestic catering and tourism. These synergies are likely to be seriously constrained in the absence of an effective system of standards and enforcement.

Financial Services and Access to Credit

37. Making finance available to the poor in rural areas remains a major challenge in Rwanda. In 2002 only 2 per cent of bank credit went to the agricultural sector. Given the primary role that the agricultural sector must play in growth and poverty reduction and that this can only be achieved through the commercialization of agricultural activities, it is of paramount importance that an effective system of rural credit be introduced that supports the decisions made by rural farmers concerning choice of crop, use of inputs such as fertilizers and where and how to market output. The Union des Banques Populaires du Rwanda (UBPR) was created in 1986 to inject capital into rural areas but take-up has remained low, in part due to the virtually non-existent level of savings - average deposit was US\$139 in 1998, while average loan was US\$444 - whilst the rural areas remain dominated by non-monetised informal agricultural activities. In addition, the UBPR and the local cooperatives suffered great physical, financial and human loss during the genocide and the civil war of 1994, and have not fully recovered yet.

⁸ Diop, N and S. Jaffee (2004) 'Global Trade and Competition in Fresh and Processed Fruits and Vegetables' in A. Aksoy and J. Beghin (eds).....

38. Elsewhere, the high cost of borrowing (currently in the region of 17.25 per cent) and the practice of banks of requiring 100 per cent collateral in the form of land and buildings severely constrain the crucial role of the financial sector in stimulating trade and growth. An analysis of the regulatory structure for financial services in Rwanda and the nature of competition in the sector is necessary to identify ways in which the credit institutions can facilitate investment and the upgrading of both the agricultural and industrial sectors. Within this the DTIS will consider carefully access to micro-finance and identify ways to support increased intermediation.

Trade Policy, Market Access and Regional Integration

39. A comprehensive assessment of Rwanda's trade policy in the context of multilateral obligations was recently completed by the WTO through the Trade Policy Review Mechanism. This will form the basis for a summary of trade policy in the DTIS, but it will be defined in the context of the objectives of the DTIS of identifying and assessing the key barriers to international integration for Rwanda and of assessing the impact of the current structure of protection on the poor. The DTIS will consider how Rwanda can respond to the Trade Policy Review Body in which members "invited Rwanda to further improve the transparency and predictability of its trade regime". The DTIS will also assess the capacity in Rwanda to develop and implement effective trade policy in the context of unilateral, multilateral and regional initiatives.

40. In terms of market access, Rwanda has duty and quota free access to the EU for all products under the Everything But Arms (EBA) initiative⁹ and has preferential access to the US under the African Growth and Opportunity Act (AGOA). However, these preferences are currently of virtually no value to Rwanda (in 2002 the value of preferences in the EU amounted to 0.33 per cent of the value of Rwanda's exports to the EU, the value of preferences in the US was 0.01 per cent of the value of exports to the US).¹⁰ This reflects that the principal products exported are not eligible for preferences: the import duty on coffee and tea in the EU and the US is zero. Hence, preferences in these markets will only be of relevance if they contribute to the diversification of exports. Elsewhere, preferences have been identified as an important element in the development of new export activities.¹¹ Indeed, one Rwandan exporter of fruit juice to Belgium was exploiting EU preferences. Nevertheless, the margin of preference is unlikely in many cases to be sufficient to offset the other costs that Rwandan exporters incur in accessing world markets relative to competitors in other countries. Further, as noted above, the rules of origin governing preferences, when defined as a value-added requirement (as is the case for AGOA and for certain products in the EU) are particularly difficult to satisfy for a country such as Rwanda facing extremely high priced imported inputs and a comparative advantage based around low labour costs. AGOA does offer the opportunity to export made-up clothing and textile handicrafts with liberal rules of origin (making up is sufficient to confer origin) until 2007. Technical assistance is being provided by USAID with regard to the export of handicrafts. The scope and potential impact of these initiatives needs to be assessed as well as the constraints to their fruition.

⁹ Rwandan exporters can also gain preferential access to the EU under the Cotonou Agreement.

¹⁰ Brenton and Ikezuki (2004) 'The Value of Trade Preferences for Africa', mimeo, World Bank

¹¹ Stevens and Kenen (2000), Diop and Jaffee (2004)

41. Rwanda is facing key market access issues at the regional level and in the future of trade relations with the EU. Rwanda is currently a member of COMESA and has also applied to join SADC as well as the EAC. Both COMESA and the EAC are aspiring to customs unions and so membership of both institutions is not feasible. At present, whilst Rwanda has been implementing the COMESA FTA (since January 2004), lack of implementation of COMESA obligations elsewhere is compromising market access conditions for Rwandan exporters. For example, Rwanda has recently reintroduced duties against imports from Uganda due to Uganda's decision not to implement the COMESA FTA. Further, Uganda is not applying the COMESA rule of origin of 35 per cent domestic content but is requiring a value-added of 45 per cent, which effectively prohibits Rwandan products. Rwanda would benefit from the introduction of a tariff shift rule of origin, as was originally envisaged for COMESA.

42. The issue of regional integration is being framed by the ongoing negotiations with the EU concerning an Economic Partnership Agreement (EPA). In addition to the issue of revenue loss (imports from the EU are mainly consumer products which in Rwanda are currently subject to the highest duties of 30 per cent although the share of imports from the EU has declined substantially in recent years whilst the share of Asia and EAC countries has increased) the EPA process will force Rwanda and other countries in the region to define a more coherent regional approach. It will also be important to consider the potential of trade diversion away from Asian and North American suppliers of basic industrial inputs towards less efficient EU suppliers and what this may imply in terms of appropriate external tariffs for Rwanda.

43. More specifically, regional integration initiatives will be of particular value to Rwanda if they help to leverage action on the key issues affecting trade, including the cost of transport and customs clearance issues, the availability and cost of finance and even energy issues. Regional institutions could also play a useful role in the development of the system of standardization in Rwanda, with the option to import certain institutions, such as certification bodies, from regional partners. A careful analysis of these issues is necessary to assist Rwanda to define a strategy in its relations with regional institutions and with the EU to maximize the available opportunities to reduce trade costs and improve access to overseas markets.

44. Whilst regional integration and relations with the EU are key issues on the trade policy agenda of Rwanda it is important to recognize that during the 1990s the main market for export growth has been Asia, which has grown to be the second largest export market for Rwanda after the EU. The Asian market continues to offer enormous potential for exporters in Rwanda and it will be important to look at market access barriers in the region and the extent to which their reduction through the multilateral process may stimulate Rwanda exports. Hence, the study will seek to highlight the implications of, and the interests of Rwanda in, the Doha Development Round, including the extent to which MFN liberalization of regional common external tariffs may be needed to reduce the potential trade diversion effects alluded to above.

45. Finally, Rwanda has been receiving a great deal of assistance in defining an export promotion strategy. The DTIS will consider how this strategy is affected by the key constraints to trade that are identified in the analysis, whether there is an appropriate focus on onshore as well as offshore objectives and if there is a relevant mix between private and public sector involvement. The aim will thus be to highlight whether there are any inconsistencies between the Export Promotion Strategy and the key conclusions of the DTIS and the main issues influencing the implementation and success of the export promotion strategy..

4. The Objectives and Approach of the DTIS

46. The Government of Rwanda, with international assistance, has drawn up a strategy to deal with various of the issues discussed above. For example, there are comprehensive strategies for the coffee, tea and tourism sectors. A broad export promotion strategy has been defined and is in the early stages of implementation. However, there has not been a careful analysis of the key constraints that may compromise the success of these initiatives in stimulating trade, growth and poverty reduction.

47. The role of the DTIS will be to provide a coherent and comprehensive view of the extent to which current and planned initiatives will come together to provide a stable environment in which trade can play a dominant role in sustaining growth at levels which generate substantial reductions in poverty. Within this a key issue will be to carefully assess the extent of synergies between different policy interventions and an analysis of appropriate sequencing and the extent to which relevant benchmarks can be set for key deliverables. For example, as argued above, a significant reduction in transport costs will be required to elicit a substantial response from exports to other initiatives regarding export promotion. Setting appropriate targets for the decline in transport costs may be necessary to ensure that resources devoted to developing transport are effective in delivering higher prices to producers and are not appropriated through uncompetitive practices elsewhere in the value chain. The expansion of the tourism sector, one of the sectors identified as a priority for development in Rwanda, is likely to increase the opportunities of a horticulture sector, but these opportunities are unlikely to be exploited in the absence of a system of standardization which ensures the supply of consistent, high quality products.

48. The key constraints to trade will also be carefully linked to analysis of two related issues that are crucial to development and long-run growth in Rwanda – private sector development and the movement of resources from the informal to the formal sector. This analysis will identify whether there are additional constraints on investment and private sector activity that will compromise the ability to invest and raise capacity to exploit international market opportunities as the key trade barriers are removed. In other words the study will discuss measures that are necessary to improve the investment environment to ensure that resources are invested to take advantage on an improved environment for trade. This will include an analysis of the updated investment code. Further, it will comment on factors which discourage activities from taking place in the formal sector,

the extent to which alleviating the key barriers to trade will encourage participation in the formal sector and whether additional measures are necessary and available.

49. The team preparing the DTIS will assess for the key issues discussed above

- the magnitude of the problem, based on existing studies and where necessary additional fieldwork,
- the current strategy and initiatives that have been defined, together with a summary of previous and existing support from donors towards these strategies,
- the extent to which these initiatives are consistent with substantial growth in trade,
- where feasible, the potential impact on poverty of addressing these problems, and the extent to which the design of current initiatives will realise their poverty reducing potential,
- the extent to which progress is affected by, and influences, development in other areas,
- make carefully defined proposals as to how the strategy may be refined in a context of stimulating trade,
- assess the capacity for successful implementation of the various initiatives in both the public and the private sectors.

50. These issue-specific approaches will be supplemented by a number of sector and commodity specific studies which will highlight the importance and impact of the main constraints identified on the dominant sectors in the economy today and on sectors deemed to be central to a more diversified economy. Hence, whilst studies have been undertaken to define strategies for the tea and coffee sectors (essentially the main prescription is to move into higher value export products), there has not been a careful analysis of the constraints to the implementation of this strategy and the impact in the face of the current high transport costs, the problems relating the energy and water supply and so on. There will also be specific analysis of the possibilities of developing horticulture and ICT economy and the major constraints to activity in these sectors. ICT has been singled out by the government as a key element in its longer term vision for the Rwandan economy, yet there has been little analysis of the economic conditions and policy environment that would facilitate the development of this sector.

51. It has to be recognized that in the short-term poverty reduction will be driven by developments affecting the key agricultural products currently exported, coffee and tea and the extent to which initiatives to increase returns to farmers and rural communities. Analysis will therefore distinguish between short-term measures to improve traditional agriculture and longer-term measures to support export growth and diversification. An important issue here will be to analyse how the new land reform law will affect the development of agricultural exports and the agricultural sector in the short and medium term.

Trade and Poverty

52. The analysis of the main constraints to trade will be brought together through an assessment of their impact on poverty in Rwanda. Such analysis will be constrained by the fact that there is no information on household incomes for a broad sample of households in Rwanda and only household expenditure data can be used. So on the one hand we can translate improvements in transport, customs clearance and reductions in other trade costs (the potential magnitude of which will be identified by the DTIS) on the price of imported products and hence on consumption bundles. However, the imported content of consumption in rural areas, where 90 per cent of the poor reside, will be very low. So there will need to be some assessment of how reduced barriers to exports and even to internal trade will impact on poverty through the impact on producer prices and output of agricultural products. One approach will be to link trade and trade barriers to poverty through household characteristics such as distance to markets and size of own consumption. For example, the study will translate increases in producer prices due to lower transport costs, for example, to greater activity in cash crop production and lower levels of own consumption to household expenditure and poverty. We will attempt to take this analysis further by considering how the nature of export growth and diversification will affect employment and the extent to which the type and location of labour demanded in new export activities will match the labour released in rural areas and what this implies for objectives concerning growth and poverty reduction..

Proposed Outline for the DTIS

i. Executive Summary (4 pages)

ii. Action Matrix (5 pages max)

1. Introduction and Socio-Economic Context (4 pages)

Paul Brenton, Raju Kalidindi, Guido Rurangwa, Kene Ezemenari (World Bank)

2. Trade and Poverty : The key constraints to trade and their impact on poverty (10 pages) Ndiame Diop (world Bank) Nicolas Minot (CGIAR)

3. Facilitating Trade: improving transport and customs clearance and export promotion, pre-requisites for improved trade performance (20 pages)

Transport - JF Arvis (World Bank), Torsten Hoffmann, Consultant, Joseph Mugenga, Chatal Katitare (local consultants).

Customs: Ahmad Boilil (consultant), Carpophore Ntagungira (local consultant)

Export Promotion: George Papazafiros (consultant) + Victor Shingiro (local consultant)

4. Developing the Private Sector: Crucial Infrastructure: Energy, Water and the Business Environment (12 pages) (Donald Lecraw, and Nikhil Desai, (consultants), C. Diawara (UNCTAD consultant financed on UN trust fund), Mary Kamari (World Bank), Celestin Semuhungu, Shema Nkanika (local consultants)

5. Financing Private Sector Development: Access to Credit for Rural Development, Growth and Trade (8 pages) C. Kalamogo, George Papazafiros (consultant), Victor Shingiro (local consultant)

6. Towards Diversification and Higher Value Exports: Standards and Quality (10 pages) Fernando Hernandez Casquet (World Bank), Sven Nycroft Rasmussen (Consultant))

7. Leveraging Access to Global and Regional Markets: Trade Policy and Regional Integration (10 pages)

(Paul Brenton, Philip Schuler, Peter Walkenhorst (World Bank))

9. Bringing it all together: a comprehensive view of the key barriers and the synergies between issues (4 pages)

Paul Brenton (World Bank)

Annexes: Commodity and Sector Studies which highlight the impact and importance of the key constraints to trade/ Analysis of sectors with greatest potential

a. Traditional agriculture: Coffee and Tea – Jeanette Sutherland (Consultant)

b. Tourism

c. Export diversification: i-Horticulture – Jeanette Sutherland (Consultant)

ii-Building an ICT Economy – Dexis Consulting Group, Raju Kalidindi (WB), Baloko Makala (local consultant)

Peer reviewers: Philip English (WBI)
Bernard Hoekman (DECRG)
John Cuddy (Geneva)

Timing and Budget

Informal Mission	June 2004
Concept Paper Preparation Mission	September 20 – 29 2004
Concept Paper Review	November 3 2004
Main Mission	November 8 – 22 2004
First Draft of Chapters	December 20 2004
Final Drafts of Chapters	January 31 2005
Draft of DTIS Report	TBD
Workshop	TBD