PDBCA 882

NOTICE OF RECORD DATE: 06/06/91

CORRECT PROJECT NUMBER IS: 696-0127

CORRECT PROJECT TITLE IS: Econ Pol Ref Pro (Prime)(PAAD)(~~AHOA~~)

VERIFIED BY: Laverne L. Horton
AFR/PD/IPS

DATE: 06/06/91

CLEARED BY: Bruce Patter
CHIEF, AFR/PD/IPS

DATE: 06/06/91

CLASSIFICATION:

AGENCY FOR INTERNATIONAL DEVELOPMENT **PROGRAM ASSISTANCE APPROVAL DOCUMENT (PAAD)**	1. PAAD Number 696-0127 Amendment #1 2. Country RWANDA 3. Category Cash Grant 4. Date July 12, 1985
5. To Mr. Edward L. Saiers Acting AA/AFR	6. OYB Change Number N/A
7. From Timothy J. Bork AFR/PD	8. OYB Increase N/A To be taken from: N/A
9. Approval Requested for Commitment of $ N/A	10. Appropriation Budget Plan Code ESF

11. Type Funding	12. Local Currency Arrangement	13. Estimated Delivery Period	14. Transaction Eligibility Date
☐ Loan ☒ Grant	☐ Informal ☒ Formal ☐ None	9/85 - 12/91	

15. Commodities Financed
N/A

16. Permitted Source		17. Estimated Source	
U.S. only		U.S.	
Limited F.W.	$2.0 million (including Rwanda)	Industrialized Countries	
Free World		Local	$10.0 million
Cash	$10.0	Other	$2.0 million

18. Summary Description

This Program Grant is a resource transfer with a technical assistance component. The purpose of the program is to assist the Government of Rwanda (GOR) make the structural and policy changes to stimulate production and employment in the manufacturing sector, particularly in the small and medium enterprises (SME) subsector.

The purpose of this amendment is to change the Conditions Precedent for the third and final disbursement under the Grant and to make provisions for the generation and use of related local currency.

All other terms and conditions of the original program grant remain in full force and effect.

19. Clearances	Date	20. Action
AFR/PD:S. Meyer	3/22/91	☐ APPROVED ☐ DISAPPROVED
GC/AFR:M. ~~MAX~~ Kleinjan (Draft)	3/25/91	Authorized Signature
USAID:H. Patrick (Draft)	3/19/91	Date 4/19/91
AFR/EA:K. Toh (Draft)	3/20/91	Title
AFR/EA:DLundberg	3/26/91	Act'g. Assistant Administrator for Africa

AID 1120-1 (5-82)

CLASSIFICATION:

POLICY INITIATIVES IN MANUFACTURING AND EMPLOYMENT
AMENDMENT #1
696-0127

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Rwanda: Policy Initiatives in Manufacturing and Employment

Amendment Number 1

I. Rationale

When the PRIME agreement was signed in 1985 it was recognized that the fundamental issues constraining production and employment in the manufacturing sector were macro issues. It was also recognized that even though the commitment to change was there, the ability to execute the change and fully understand its implications was not. It was decided, however, to move ahead with the second best solution; e.g., to begin a dialogue thru PRIME that would eventually lead to the appropriate macro reforms.

Work done by A.I.D. as well as the IBRD and the IMF since the initiation of PRIME has identified specific macro level changes that are necessary. Examples come from studies done under PRIME, the Rwanda Private Sector Strategy Assessment USAID did under the MAPS effort, the IBRD Policy Framework Paper, the IMF Article IV Consultation and Request for Arrangements under Structural Adjustment Facility. All have led us to the decision to amend the final tranche conditionality of PRIME as a more effective means to achieve the original purpose of the program.

II. Program Factors

A. Macroeconomic and Policy Climate

During the past four years, the Rwandan economy and government finances have deteriorated drastically. Since 1987, precipitous declines in the world coffee prices and unfavorable climatic conditions have dealt severe setbacks to the Rwandan economy. As coffee accounts for over 80% of Rwanda's export earnings, lower world coffee prices have an immediate negative impact on the country's foreign exchange earnings. In 1989, coffee prices dropped by nearly one half of the 1988 price. This drop contributed to a precarious balance of payments situation: the current account deficit increased to 10.7% of GDP in 1989 and foreign exchange reserves at mid-1990 were estimated to be less than two months of imports. As of mid-January 1991, the Government was estimated to have about three weeks of foreign exchange reserves. A.I.D. has learned that the Rwandan Central Bank has begun tapping commercial lines of credit--many extended by the Belgian Banks--to finance imports.

Another factor which contributed to Rwanda's weakened balance of payments position, was the significant appreciation of the Rwandan franc. By 1990, the Rwandan franc had appreciated about 30% vis-a-vis the currencies of its major trading partners. This appreciation reduced the competitiveness of the country's exports and the potential of the manufacturing sector and the potential of small and medium enterprises to achieve their production and employment objectives. Moreover, minimum hourly wages for semi-skilled labor in Rwanda (measured in US dollar terms) was higher than those in other African countries: about three times the level in Madagascar and about twice the level in Kenya. The deteriorating balance of payments situation led to the imposition of strict exchange controls and quantitative restrictions on imports to protect shrinking foreign exchange reserves. Consequently, the Rwandan economy contracted by 2% in 1989 and the trade deficit widened by about 6%, to over $160 million.

B. Prospects for Comprehensive Reform

Although the GOR has not entered into a formal negotiated agreement with the World Bank and the IMF, it has signed a letter of intent pledging to reach agreement. In September 1990, the Government approved a draft Policy Framework Paper (PFP) which was prepared jointly with the Bank and Fund. The Key macro-economic objectives of the program are to reach a growth rate of 4% a year by 1992, and to contain the annual inflation rate to 5% by 1993. The macro-economic management strategy envisaged a substantial exchange rate adjustment and an interim system to reach market-determined exchange rates within 12 months. This framework represented a move toward stronger reliance on market forces and the private sector. To promote private sector involvement in the economy, the Government intends to liberalize the foreign exchange allocation in line with external resources availability. The draft PFP also set objectives for the agriculture sector and for achieving food security in an environmentally sustainable way. The overall objectives of the Bank/Fund Program are outlined in the policy framework matrix which is attached as Annex I.

Unfortunately, the current conflict has delayed the early signing of an accord. Rwanda was invaded by Rwandan exiles from Uganda in October 1990, and fighting has continued sporadically since. The resulting insecurity, and economic and social dislocation preoccupied GOR officials to the exclusion of other important government business. In view of the deteriorating economic situation, the Bank and the Fund reappraised the economic scenario in early 1991 and revised macro-economic targets.

A joint Bank/Fund Mission in which an A.I.D. representative participated, visited Rwanda in February 1991 to assess the impact of the hostilities and to adjust the proposed program accordingly. The Mission concluded after considering Bank and Fund disbursements, that the financing gap for the 1991-1993 period had risen from $169 million to $181 million. This meant that bilateral donors would have to provide approximately $109 million in program assistance during 1991 to cover the residual financing gap. See Annex II for a summary of key economic data.

II. Original PAAD Conditions Precedent

The original conditions precedent to the disbursement of the third tranche requires that the GOR

-- Review tariff related recommendations resulting from the Industrial Incentives Study and adopt major recommendations;

-- Provide evidence of continued satisfactory performance in the allocation and disbursement of local currency; and

-- Provide evidence that program performance targets under conditions precedent (1) and (2) to the second tranche have been met. These related to promulgation of a revised Investment Code, adoption of procedures to facilitate SME access to a Guarantee Fund, repeal of the requirement for prior approval of prices and easing reporting procedures for small enterprises, and satisfactory progress in undertaking an industrial incentives study.

However, based on discussions in February 1988 among the GOR, USAID/Rwanda, and REDSO/ESA, it became clear that these reforms were not the most important sector-specific reforms for development of the manufacturing sector. For instance, it became clear that the specific benefits of the investment code and the special guarantee fund were far less important than the administrative procedures required to register a business, which were found to take years and were a prerequisite for receiving benefits under the investment code, the loan guarantee fund, or even the routine benefits of contract law. Similarly, the PAAD and the grant agreement's emphasis on tariff reform as the basis for the third tranche conditionality was clearly misplaced, since much of the protective structure in Rwanda results from import licensing rather than from tariffs.

With a view to identifying the more relevant obstacles to the development of the manufacturing sector, the project assistance component of PRIME then undertook two studies to explore constraints related to trade policy, as well as a study of the financial system. The PRIME long-term advisor finally combined the two studies into one larger effort which produced working paper no. 9, "A Diagnostic Study of Medium and Large Private Manufacturing Firms". This study provided roughly thirty recommendations to reduce obstacles to the development of the SME sector. As a result of this study, the mission and the GOR informally agreed to adopt three of the most important of its recommendations as replacement conditions precedent for disbursement of the third tranche of PRIME. These proposed new

CPs were: (1) simplification of the administrative procedures required to start a new business; (2) creation of a national investment fund, primarily to assist SMEs; and (3) development of a program which would set aside a portion of GOR procurement for SMEs. The requirement for the GOR to "provide evidence of continued satisfactory performance in the allocation and disbursement of program local currency" was the only one of the original CPs retained.

The USAID subsequently requested AFR's approval of the newly developed CPs for the release of the third tranche. AFR recommended that the Mission consider linking the release of the third tranche to GOR progress in World Bank/IMF structural reform discussions instead of the revised CPs. This was suggested because the MAPs study as well as studies conducted under PRIME indicated that certain macroeconomic constraints, and thus macroeconomic reforms, were more important to the manufacturing sector than those three sector-specific ones, and that without those macroeconomic changes the sector-specific ones would not have much effect. It also became clear that the GOR had not agreed upon these changes with the IMF, and thus it became appropriate for A.I.D. to address them in PRIME. Thus, AFR recommended that the mission consider linking release of the third tranche of PRIME to GOR progress on those macroeconomic areas being pursued by the IMF that were also of paramount importance to the manufacturing sector instead of the conditions proposed by the mission, but gave the mission a choice. The mission chose to link the third tranche to the macroeconomic progress. The analysis done under the MAPS program in 1989-90 indicated that the constraints to the manufacturing sector centers on the following:

(1) The exchange rate policy and overvaluation of the Rwandan franc
(2) Protectionism and import institution bias including inappropriate interest rates
(3) Taxation policy including existence of export taxes, inappropriate import taxes, and inequitable and unpredictable import taxes.

Other areas identified but requiring further analyses include price controls, hiring procedures, and business registration procedures. The GOR has recently signed a Letter of Intent with the IMF embodying these, as well as other, reforms. The GOR has already accomplished some of the reforms contained in the Letter of Intent, especially certain of them addressing those constraints relevant to the manufacturing sector. It is appropriate to disburse against these already-accomplished reforms, since the GOR undertook them in the context of its discussions with A.I.D. and other donors about PRIME, as well as about the broader IMF program. By signing the Letter of Intent and undertaking some of the reforms on its own, the GOR indicated its seriousness about the reform process. In light of this, it is appropriate to agree to amend the conditions required to obtain disbursement under PRIME.

The intervening deterioration of the economy and the extremely poor state of government finances make it more important that A.I.D. support the more comprehensive measures undertaken so far and expected under the Bank/Fund program. Further, continuation of the IMF/Bank program as a whole will make it more likely that the reforms supported by the third tranche of PRIME will succeed.

The proposed $3.5 million disbursement along with contributions from other donors will assist the government in meeting essential financial requirements until the Bank/Fund program comes on line in May or June of 1991.

IV. Alternative Conditions Precedent

In light of the foregoing, the following alternative conditions are substituted in this PAAD for the disbursement of the third and final tranche:

Prior to the third disbursement under the Grant, in the amount of $3.5 million, or to the issuance of documentation by A.I.D. pursuant to which such disbursement may be made, the Grantee shall submit to A.I.D., in form and substance satisfactory to A.I.D., evidence that:

- The Rwandan franc has been devalued 67% vis a vis the SDR;
- Commercial interest rates have been revised to provide for a minimum deposit rate of 12% and a maximum borrowing rate of 19%, and preferential interest rates for various categories of loans have been abolished;
- Export taxes, except for coffee, have been eliminated;
- Import taxes have been increased from 5% to 10%, including taxes on intermediate goods for protected industries which were previously exempted under the investment code; and
- Business taxes have been revised to make them more equitable and more predictable.

While of critical importance to the competitiveness of the Rwandan economy and especially the manufacturing sector, exchange rate adjustments were not included in the package of proposed 1988 reforms because A.I.D. felt that such an all encompassing reform was simply beyond the scope of the PRIME program. In fact, a 1989 study of constraints to the manufacturing sector and especially SMEs conducted by REDSO/ESA under PRIME concluded that because of the overvalued exchange rate, Rwandan manufactured goods generated "negative value added" in terms of the currencies of contiguous countries. The existence of "export taxes" further reduced the competitiveness of Rwandan manufactured goods and hence the role of the Rwandan manufacturing sector and the small and medium enterprises with their relatively high labor intensity factor. The revision of business taxes to make them more transparent, equitable and predictable in terms of business operations and the role they play in profitability, will further improve the enabling environment for the manufacturing sector and small and medium enterprises. More transparent and predictable savings and lending rates will also improve the enabling environment for the private and manufacturing sectors. Collectively, the above reforms far exceed those proposed in 1988 for the third disbursement in terms of their impact on the manufacturing sector and small and medium enterprises.

V. Disbursement of Funds

FY 1985 funds are not subject to separate account and tracking requirements, and therefore, will be disbursed as an untied, untracked cash transfer. The GOR will deposit an equivalent amount of local currency in a separate interest bearing account to be jointly programmed by USAID and the GOR. This local currency will be used for activities to promote the private sector.

Clearly, the release of the $3.5 million will only cover a small percentage of the estimated $109 million first year financing gap of the Bank/Fund program. However, a special March 20, 1991 donor consultative group meeting in Paris. The need was identified and justified. Although small in terms of total need the $3.5 million, when combined with other donor commitments, will result in successful initiation of a major restructuring of Rwanda's stalled economy, particularly the role of the private sector in that economy.

Attachments: Annex I, Structural Reform Policy Matrix

Annex II, Macro Economic Data

Annex III, MAPS: Rwanda, Private Sector Strategy Assessment: Phase V (Draft)

References:

1. World Bank: Rwanda - Policy Framework Paper, 1991 to 1993 (scheduled for review April 23, approval is expected.

2. World Bank: Rwandese Republic - First Structural Adjustment Credit (still under discussion with the GOR, currently scheduled for Executive Board Review, June 18).

3. World Bank: Rwanda - Agricultural Strategy Review (the document will provide the basis for policy dialogue and for the development of a sectoral SAL, which according to the current planning is to follow the first SAL, probably sometime in the first half of 1992.

4. IMF: Rwanda - Article IV Consultation and Request for Arrangements under Structural Adjustment Facility (the document was issued this month, Executive Board review together with the PFP is scheduled for April 24).

Sector	Objectives	Measures	Timetable
1. Exchange and Trade Policy Regime			
a. Exchange Rate	Achieve a market clearing exchange rate.	An initial devaluation.	* Devaluation on 11/9/90.
		The exchange rate policy will be regularly examined and adjustments will be made if necessary.	During Program period.
b. Foreign Exchange Allocation and Import Liberalization	Liberalize imports.	Elimination of import prohibitions except for items normally prohibited for health or security reasons.	* Spring 1991
		Implementation of a "Liberalized Import Regime" (LIR) covering 70% of imports; temporary import programming for essential goods, representing 30% of the value of imports.	* Announced on 11/9/90 and to take effect in Spring 1991.
		Establish an open General Licensing System (OGL) to cover all imports, except for petroleum.	** Spring 1992
	Eliminate restrictions on payments for services.	Eliminate delays on transfers of profits and income of foreign investors.	Monitored under SAF.
c. Tariff Regime	Rationalize the tariff structure by moving to ad valorem rates and to a uniform structure with fewer tariff categories and reduced spread.	Convert specific taxes to ad valorem for all products, except for petroleum products, beverages and cigarettes.	Announced on 11/9/90 and to take effect in March 1991.
		Establishment of a tariff commission.	* March 1991
		First phase of tariff reform incorporated in 1991 budget. (Minimum tariff at 10% and maximum tariff at 100%.)	* April 1991. Measure already approved by National Council for Development.
		Implementation of 2nd phase of tariff reform in 1992 budget. Lower the maximum customs duty rate to 80%.	** January 1992
2. Incentives for Private Sector Growth			
a. Pricing Policies	Eliminate price distortions.	Eliminate all controls over profits margins, except for natural monopolies.	* March 1991
		Abolish fixed prices for all products, except for a small number of goods and services.	Announced on 11/9/90 and to be completed by mid-1991.

* Board condition.
** Second tranche release.

Sector	Objectives	Measures	Timetable
		For goods and services whose prices remain fixed, the full impact of the exchange rate adjustment will be passed through.	March 1991
		For natural monopolies, agreement on principles of pricing in line with sound financial practices.	March 1991
b. Regulatory Framework	Liberalize and simplify procedures for business creation.	Eliminate the discretionary power of the Minister of Commerce in approving establishment of private businesses.	* March 1991
		Prepare an action plan to eliminate impediments.	January 1992 (implementation monitored under subsequent operations).
	Encourage labor mobility.	Abolish requirement for enterprises to hire from Ministry of Labor list.	*April 1991
		Launch labor market study.	June 1991
		Prepare action plan on labor market liberalization.	mid-1992 (implementation monitored under subsequent operations).
3. <u>Supply Side Measures</u>			
a. Coffee Sector	Improve the efficiency of the coffee sector.	Liberalize gathering, processing and export of coffee; establish export reference price and eliminate remaining permanent activity.	** March 1992
		Prepare action plan based on sector strategy study.	September 1991 (implementation monitored under Agricultural Sector operation).
b. Energy	Improve sector efficiency.	Establish financial objectives for ELECTROGRAZ and increase electricity rates accordingly.	** March 1992
		Complete Power Master Plan.	Mid 1992
		Adopt new tariff structure in line with LRMC.	Monitored under subsequent operations.
4. <u>Public Resource Management</u>			
a. Programming and Monitoring of Public Expenditures	Improve programming and monitoring of current and capital expenditures, while ensuring social "safety net".	Agreement on the 1991-93 PIP and 1991 budget.	* February 1991
		Agreement on 1992-94 PIP, the 1992 budget, and PEP for Health, Education Agriculture and Transport.	** End 1991
			1993 Budget

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Sector	Objectives	Measures	Timetable
		Public Expenditure programming extended to all sectors.	
	Reduce the consolidated budget deficit of the Central Government.	Government deficit target of 5.2% of GDP in 1993.	Monitored by the IMF under SAF/ESAF.
b. Reform of the Civil Service	Rationalize civil service.	Agree on action plan to reform civil service.	** February 1992
c. Tax Reform	Improve efficiency of the tax system; increase the share of income and consumption taxes in Government revenue; and encourage private sector investment.	Raise the sales tax from 2% to 5% for essential goods, to 10% for services.	Approved by the CND on 11/30/90; to take effect in early 1991.
		Increase specific import taxes on petroleum products in line with exchange rate adjustments.	* 75% increase in petroleum prices on 11/9/90
		Prepare an action plan to implement remaining recommendations of the fiscal review.	End 1991
d. Public Enterprises	Withdrawal of the State from productive and commercial activities.	Adoption by the government of a general privatization strategy.	September 1991 (monitored under PE Reform Project).
		Presentation of public enterprise legislation to the Parliament.	December 1991 (monitored under PE Reform Project).
		Rehabilitation, privatization and liquidation of public enterprises to be completed in stages.	Monitored under PE Reform Project.
5. <u>Social Aspects</u>			
	Protect vulnerable population groups against the temporary effects of adjustment and promote social development.	Establish social "safety net" in public expenditre program, consistent with sound macroeconomic framework: - Maintain delivery of social services at present level. - Labor intensive program for rural road construction and soil erosion protection. - Finance parental share of education expenditures for poorest 10 percent. - Microentrepreneurial development program. - Food security program. - Redeployment fund for civil servants.	Implementation to be monitored within the framework of public expenditure reviews.

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RWANDA : Balance of Payments, 1985-95
(in millions of U.S. dollars)

	1985	1986	1987	1988	1989	1990	Projections 1991	1992	1993	1994	1995
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A. Exports of Goods & NFS	161.2	227.7	167.8	161.4	148.0	153.9	151.7	163.2	188.1	216.5	247.7
1. Merchandise (FOB)	126.1	184.1	121.4	117.9	104.8	109.0	110.9	120.3	135.6	155.3	178.1
2. Non-factor services	35.1	43.6	46.4	43.6	43.2	44.9	40.8	42.9	52.5	61.2	69.6
B. Imports of Goods & NFS	335.8	412.5	418.4	421.0	379.0	368.1	417.6	420.6	452.2	486.0	523.3
1. Merchandise (FOB)	219.1	259.2	267.0	278.5	254.2	233.3	276.2	278.2	299.6	323.7	351.3
2. Non-factor services	116.7	153.3	151.4	142.5	124.8	134.8	141.3	142.4	152.6	162.3	172.0
C. Resource Balance	-174.6	-184.8	-250.6	-259.6	-231.0	-214.2	-265.8	-257.4	-264.1	-269.5	-275.6
D. Net Factor Income	-5.6	-8.4	-9.9	-14.2	-9.9	-14.3	-22.1	-19.6	-18.9	-18.1	-18.3
1. Factor Receipts	9.0	9.1	10.0	8.3	8.9	3.8	5.0	7.4	9.6	12.0	13.6
2. Factor Payments	-14.6	-17.5	-19.9	-22.5	-18.8	-18.2	-26.1	-27.1	-28.5	-30.1	-32.0
(interest payments)	-4.0	-5.4	-7.4	-9.4	-7.8	-9.6	-11.3	-11.1	-11.1	-11.3	-11.5
E. Net Current Transfers	4.3	7.0	7.5	10.6	8.2	6.5	7.6	9.5	12.2	13.9	15.7
1. Current Receipts	18.5	26.1	28.8	32.2	27.5	26.6	29.2	32.0	35.6	38.3	41.0
a. total	18.5	26.1	28.8	32.2	27.5	26.6	29.2	32.0	35.6	38.3	41.0
b. other current transfe	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2. Current Payments	14.2	19.1	21.3	21.6	19.3	20.0	21.6	22.5	23.4	24.3	25.3
F. Current Acc. Bal. (no gra	-175.9	-186.2	-252.9	-263.2	-232.7	-222.1	-280.3	-267.6	-270.8	-273.7	-278.2
Current Acc. Bal. (with g	-63.8	-69.2	-134.4	-123.9	-105.1	-99.4	-158.5	-131.2	-140.5	-140.9	-139.8
G. Long-Term Capital Inflow	184.6	200.2	226.7	224.1	188.1	156.5	212.1	240.7	247.6	249.7	259.5
1. Direct Investment	14.6	17.6	17.5	21.1	15.6	5.6	5.6	10.1	11.6	13.3	15.3
2. Official Capital Grants	112.1	117.0	118.6	139.3	127.6	122.7	121.9	136.3	130.3	132.8	138.4
3. Net Long Term Loans	58.0	65.7	89.9	63.0	45.5	28.3	84.6	94.3	105.8	103.6	105.8
a. Disbursements	66.1	79.7	110.1	81.1	64.8	45.9	105.0	117.1	129.7	129.4	132.7
b. Repayments	8.1	14.0	20.2	18.1	19.3	17.6	20.4	22.8	23.9	25.8	26.9
4. Other LT Inflows (net)	0.0	0.0	0.7	0.8	-0.6	0.0	0.0	0.0	0.0	0.0	0.0
H. Total Other Items (net)	-8.7	15.2	7.8	0.2	6.2	1.0	0.0	0.0	0.0	0.0	0.0
1. Net Short Term Capital	-8.0	18.2	11.4	-2.2	4.9	-1.6	0.0	0.0	0.0	0.0	0.0
2. Capital Flows n.e.i.	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
3. Errors and Omissions	-0.7	-3.0	-3.6	2.4	1.3	2.6	0.0	0.0	0.0	0.0	0.0
[check: Overall balance]	0.0	29.2	-18.4	-38.9	-38.4	-64.5	-68.3	-26.9	-23.2	-24.0	-18.7
I. Financing	0.0	-29.2	18.4	38.9	38.3	64.6	-41.5	-10.5	-12.2	-10.2	-10.2
1. Net Credit from the IMF	0.0	0.0	0.0	0.0	0.0	0.0	12.6	19.0	12.8	0.0	0.0
2. Net Reserve Changes	0.0	-29.2	18.4	38.9	38.3	57.9	-47.5	-29.5	-25.0	-10.2	-10.2
(- indicates increase)											
3. Arrears						6.6	-6.6				
J. Financing gap						0.0	109.8	37.4	35.4	34.2	28.9
Share of GDP :											
1. Resource Balance	-10.2%	-9.5%	-11.6%	-11.2%	-10.6%	-10.1%	-14.4%	-11.9%	-11.1%	-10.4%	-9.7%
2. Interest Payments	-0.2%	-0.3%	-0.3%	-0.4%	-0.4%	-0.5%	-0.6%	-0.5%	-0.5%	-0.4%	-0.4%
3. Current Account Balance	-10.3%	-9.6%	-11.7%	-11.3%	-10.7%	-10.4%	-15.2%	-12.4%	-11.4%	-10.5%	-9.8%
Memorandum Items :											
Net reserves (months' import	3.9	5.0	4.6	3.2	1.9	-0.1	1.5	2.5	3.1	3.2	3.3
Net reserve level, dollars	104.1	150.6	146.7	97.5	55.7	-2.2	45.2	74.7	99.8	109.9	120.1

Part II : Government Revenues and Expenditures (Millions Rw Francs) (continued)

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	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
					Estimates		Projections				
Total revenue and grants:	26033	28022	27230	29499	29865	27665	37002	41149	44626	48812	52533
Total revenue	21183	23544	23130	23317	24073	21879	29020	32337	36488	40611	44336
Tax revenue	18764	21468	20176	19996	20888	18583	25968	28405	32020	35630	38787
Tax on income and profits	4085	4261	4639	5187	5238	4888	5282	6160	7535	8423	9006
Corporate	1371	1238	1525	1209	1136	1063	500	1100	1676	1962	2122
Patente	511	624	630	680	737	735	725	1076	1313	1509	1632
Individual (professional	1686	1896	1917	2079	2147	1945	2001	2447	2732	2989	3130
Other (incl. arrears)	517	503	567	1219	1218	1145	1256	1537	1815	1962	2122
National solidarity tax							800				
Taxes on property	403	423	451	537	589	574	620	726	795	862	936
Domestic taxes on goods an	5260	5315	6260	6552	7456	6553	8134	10032	11432	13262	4811
Excises	5260	4745	4910	5192	6015	5292	5134	6179	6966	8255	9191
Sale taxes		570	1350	1360	1441	1261	3000	3853	4467	5007	5619
Taxes on internat. trade	9016	11469	8826	7720	7605	6568	11932	11576	12257	13082	14034
Import duties	5756	6249	6119	6118	5933	4829	10430	10044	10662	11424	12309
Custom duties (+ MAGER	5756	5978	5185	5480	5241	4206	7800	8710	9300	9963	10734
Road Fund		271	934	638	692	623	1530	1334	1362	1460	1575
Import license fee							1100				
Export duties	2988	4981	2448	1355	1441	1506	1371	1386	1441	1499	1559
Coffee	2519	4920	2445	1267	1383	1467	1371	1386	1441	1493	1559
Other	469	61	3	88	58	39	0	0	0	0	0
Other taxes (peage etc.)	272	239	259	247	231	233	131	147	154	160	167
Non-tax revenue & Adjustment	2419	2076	2954	3321	3185	3296	3052	3943	4468	4981	5549
Stabex				1957	1642	1830	524	261	0	0	0
Other grants				4225	4150	3956	7457	8550	8137	8201	8257
Total grants	4850	4478	4100	6182	5792	5786	7902	8811	8137	8201	8257
Total Expenditure (commit ba	32259	35575	40731	38531	36647	42342	49227	48958	50788	52297	54207
Current expenditure	17321	20192	23954	23827	23916	31029	31607	28499	29185	30467	31736
Wages and salaries	8753	9487	10108	10710	11000	11803	12903	12879	13326	14234	14306
Purchases goods & services	4815	5925	5792	6060	5567	3766	11002	7163	7808	8441	9223
Interest payments	1233	1398	1811	2037	2030	2197	4496	5412	4731	4204	3727
on domestic debt	850	974	1229	1349	1290	1504	3172	4053	3377	2845	2355
on foreign debt	383	424	582	688	740	693	1324	1359	1355	1359	1372
Subsidies and transfers	2338	2816	5554	4280	4916	7076	3200	3045	3320	3583	3880
Budget ordinaire	2261	2391	2368	2670	2851	3046	3200	3045	3320	3583	3880
OCIR-coffee	77	425	3186	1610	2065	4030	0	0	0	0	0
Unclassified expenditure	182	566	603	740	403	187	0	0	0	0	0
Capital expenditure	14938	15383	16837	14704	12731	11313	17620	20459	21603	21820	22471

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Domestically financed	3396	3924	3367	4280	3400	3555	3000	3360	3528	3814	4124
Externally financed	11542	11459	12870	10424	9331	7758	14620	17099	18075	18006	18347
- grant financed	4050	4478	4100	4225	4150	3956	7457	8550	8137	8201	8257
- loan financed	6692	6981	8770	6200	5181	3802	7163	8549	9938	9805	10091
Total revenue minus current expenditure	3863	3352	-824	510	157	-9150	-2587	3838	7303	10144	12600
Lending minus repayment	161	506	229	249	160	177	269	176	185	192	200
Ordinary budget	132	273	35	93	0	73	269	79	83	86	90
Other treasury accounts	29	233	194	156	160	104	0	97	102	106	110
Deficit (commit.), incl. gra	-6387	-8059	-13730	-9282	-6942	-14854	-12434	-7986	-6347	-3667	-1814
Deficit (commit.), no grants	-11237	-12537	-17830	-15463	-12734	-20640	-20476	-16797	-14485	-11868	-10070
Change in arrears (- =reduct	-353	0	924	992	-2208	5336	-5336				
Deficit/Surplus (cash basis)	-6740	-8059	-12866	-8290	-9150	-9518	-17831	-7986	-6347	-3667	-1814
Discrepancy				529	600	0					
FINANCING :	6740	8059	12866	7761	8550	9518	17831	7986	6347	3667	1814
1. Foreign net	6032	6033	7840	5046	4101	2619	4689	5845	7130	6805	6998
Drawing	6692	6981	8770	6200	5181	3802	7163	8549	9938	9805	10091
Amortization	-660	-948	-930	-1154	-1080	-1183	-2474	-2704	-2808	-3000	-3092
2. Domestic (net)	708	2026	5026	2715	4449	6899	30	2140	-783	-3138	-5184
Banking System, net	-243	1169	4446	1355	2649	5619	-840	-250	-783	-3000	-3500
Non-bank, net	951	857	580	1360	1800	1280	870	2390	0	-138	-1684
3. Financing gap							13111				
as % of current GDP							5.9%				
	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
MEMO ITEMS :	----	----	----	----	----	----	----	----	----	----	----
Defense expenditure					3316	7953	9385	4572	4518	4816	5089
Wages and salaries					1763	2130	2887	2454	2209	2320	2390
Goods and services					1554	5823	6498	2118	2309	2496	2699
Non-defense expenditure											
Wages and salaries					9237	9673	10022	10425	11117	11913	12516
Goods and services					4013	3943	4504	5044	5499	5345	6524
Domestic debt stock	14333	16509	21058	23992	28842	35741	35771	37912	37129	33931	28807
Domestic debt /GDP	8.3%	9.7%	12.2%	13.5%	16.6%	20.3%	16.2%	14.8%	13.3%	11.3%	8.8%
Nominal GDP	173698	170339	171911	177932	174197	176021	220582	256182	279275	301695	326424
As a percent of GDP											
Deficit (commit.) incl. g	-3.7%	-4.7%	-8.0%	-5.2%	-4.0%	-8.4%	-5.7%	-3.1%	-2.3%	-1.2%	-0.6%
Deficit (commit.) excl. g	-6.5%	-7.4%	-10.4%	-8.7%	-7.3%	-11.7%	-9.3%	-6.6%	-5.2%	-3.9%	-3.1%
Deficit (cash) excl. gran	-6.7%	-7.4%	-9.9%	-8.1%	-8.6%	-8.7%	-11.7%	-6.6%	-5.2%	-3.9%	-3.1%
Current Deficit or Surplu	2.2%	2.0%	-0.5%	-0.3%	0.1%	-5.2%	-1.2%	1.5%	2.6%	3.4%	3.9%

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MAPS: RWANDA
Private Sector Strategy Assessment: Phase V

DRAFT REPORT
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Bureau for Private Enterprise
U.S. Agency for International Development

Prepared for:	*USAID/Rwanda*
Prepared by:	*SRI International* *J.E. Austin Associates*
Sponsored by:	*Private Enterprise Development Support Project II* *Project Number: 940-2028.03* *Prime Contractor: Ernst & Young*

February 1990

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PRIVATE SECTOR STRATEGY ASSESSMENT

This document presents the major findings of the Private Sector Strategy Assessment, Phase V of MAPS/Rwanda. The work was undertaken by SRI International and J.E. Austin Associates under the Private Enterprise Development Support (PEDS) project. This summary is based on work from the first four phases of MAPS/Rwanda: 1) Articulation of Current USAID Strategy; 2) Description of the Rwandan Private Sector; 3) Diagnostic Survey of the Rwandan Private Sector; and 4) Summary of Dialogue with Private Sector Leaders and Public Sector Officials.

I. OBJECTIVES OF THE PRIVATE SECTOR STRATEGY ASSESSMENT

The purpose of the Private Sector Strategy Assessment is to review current USAID/Rwanda private sector strategy and make recommendations on actions for future private sector initiatives.

The specific objectives are as follows:

A. To offer a full range of programmatic options for private sector initiatives consistent with AID priorities;

B. To ensure that AID's strategy is consistent and mutually reinforcing; and

C. To assess the feasibility of the options given the analysis that has been conducted.

II. STUDY METHODOLOGY

The Private Sector Strategy Assessment is based on the work of four previous phases:

A. Articulation of Current USAID Strategy: The MAPS team articulated current Mission strategy. This helped the team to tailor MAPS to meet the specific needs of the Rwanda Mission.

B. Description of the Rwandan Private Sector: A description of the private sector and its role in the economy was carried out in order to investigate key questions raised by Mission personnel. This information will serve as a useful data base for the Mission and can be continuously updated.

C. Diagnosis of Private Sector Constraints and Opportunities: A private sector survey analyzed results from a random sample of 260 Rwandan enterprises. The survey focussed on the business environment, resource and policy constraints to growth, investment opportunities, and potential project implementing agents such as business associations.

D. Dialogue with the Private Sector: Mission personnel and MAPS consultants conducted numerous dialogue sessions with private sector leaders, business associations, donor organizations, and public sector officials engaged in activities directly influencing the private sector. These sessions included formal focus group discussions with sectoral, scale, and gender themes, as well as informal discussions with a wide range of individuals from the private sector.

Based on the major findings of the previous four phases, a strategy formulation was developed using the logical framework methodology which is familiar to all Mission staff. The strategy formulation is presented in Section IV, following the discussion of the main findings in Section III below.

III. STUDY FINDINGS

The following is a summary of major findings from the previous phases relevant to the design of USAID private sector strategy.

A. The current policy environment is not conducive to private sector investment and growth. The Government policy stance remains strongly control-oriented and is viewed as stifling to many of the private sector actors in Rwanda. Private investment is low, equaling 6 percent of GDP.

B. The economic situation in Rwanda has deteriorated in the past year, according to a majority of businesses sampled in the private sector survey. Sales volumes in 1989 were significantly lower than in 1988. About half of the firms surveyed were operating at less than 50 percent of capacity.

C. Exports have declined sharply over the last three years. The trade deficit amounted to about 12 percent of GDP in 1988. Coffee and tea represent over 90% of exports. Export diversification and export promotion are needed to generate new sources of foreign exchange.

D. The Rwandan economy is dominated by the private sector. The private sector contributes close to 80% of GDP -- which is a very high percentage compared with most African countries. The private sector is also responsible for 94% of total employment. The economy is dominated by the agricultural (42% of GDP), services (42%), and manufacturing (16%) sectors, which are 95%, 66%, and 67% private, respectively.

E. The private sector is small scale. The rural and informal private sectors are dominant; it is estimated that 91 percent of the population is involved in either agriculture or informal activities. Only 9% of Rwandans are employed in the modern formal economy; the formal private sector represents 3% of total employment. Sixty-five percent of the firms surveyed employed less than 5 people.

F. Credit is not available to most firms. Rwandan enterprises rely on their own capital resources. Only large firms, mainly in the commerce sector, have any significant recourse to bank credit. Limited business lending hinders private capital formation and economic growth.

G. Business skills are lacking. Basic skills necessary to manage businesses profitably need upgrading. Finance, accounting, marketing, and general management training are priority areas for training to improve business performance. Most businesses in Rwanda place training as a low priority area for investment, leading to an underutilization of potential human resources.

H. Private sector support groups are generally not performing well, according to a majority of businesses sampled in the private sector survey. Fifty-two percent of the members of the Chamber of Commerce surveyed rated it as ineffective. Firms stated an interest in associations providing them with more information on export markets, providing training, and helping them get access to credit.

I. USAID is in a position to pioneer private sector assistance. The Mission's knowledge of and contact with the private sector has been growing over the past three years. It now has in-house data and personnel to target private sector assistance, as part of an effort to further its goal of broad-based sustainable economic development.

IV. STRATEGY FORMULATION

In order to build a consensus on the formulation of a coherent private sector strategy, the MAPS team and the Mission participated in a Private Sector Strategy Retreat at the Hotel Horizon on January 29, 1990. The methodology used to help define the Mission's private sector strategy was broadly based on the logical framework, which is a management tool for establishing strategies, objectives, and indicators for programs and projects, familiar to Mission staff.

Because this MAPS Phase is concerned with formulating a broad private sector strategy, detailed indicators were not established at this time. However, with the strategy framework provided by this document, they should be easily developed during the planning of the upcoming private sector project and the preparation of the next CDSS.

In the paragraphs which follow, goals, assumptions, core problems, and types of enterprises to be targeted are presented as part of a logical framework to help build the Mission's private sector strategy. In Section V, action options are presented to overcome the core problems identified below:

A. Strategic Goals:

1. To increase productive and sustainable employment.

2. To raise economic growth.

The above two goals are considered to be national private sector objectives to which Mission program objectives will contribute.

B. Assumptions:

1. The Rwandan private sector is handicapped by a lack of commercial tradition and by a shortage of basic managerial and technical skills.

2. The lack of private sector tradition and skills notwithstanding, private entrepreneurs in Rwanda respond to commercial opportunities and incentives similarly to business people throughout the world.

C. Core Problems:

- Constraining policy environment
- Low levels of private investment
- Poor export performance
- Little access to credit for small businesses
- Ineffective private sector support associations
- Limited management and technical skills

D. <u>Types of Enterprises to be Targeted for AID Assistance:</u>

The MAPS team along with the Mission staff narrowed the focus of the types of firms which should be targeted for AID assistance and project interventions. The questions considered included:

1. Size concerns -- large vs. small

A consensus was reached that <u>AID will continue to focus its assistance efforts on smaller enterprises</u>. This was based on the following grounds:

(i) The vast majority of firms in Rwanda are small-scale (65% of the firms surveyed employed less than 5 people);
(ii) Smaller firms make greater use of local resources and therefore have a more positive net foreign exchange impact (as evidenced by research under the prime project and confirmed by the MAPS private sector survey); and
(iii) Smaller firms tend to need the most help because of their restricted financial resources and limited technical expertise.

2. Geographical concerns -- Rural vs. urban

It was determined that <u>a majority of the private enterprises assisted by AID will be rural</u>. Over 90% of the population in Rwanda is rural, and a majority of the small businesses are outside of the capital, therefore by definition AID will be targeting small rural businesses. However, this will not preclude small urban enterprises from benefitting from AID support.

3. Cooperatives vs. individual businesses

Because there are advantages to working with both individual businesses and cooperatives in Rwanda, it was resolved that <u>AID will assist both types of business establishments, and training should be available to individual businesses as well as cooperatives</u>.

It was emphasized that there are many advantages to delivering assistance through cooperatives in Rwanda. For example it is simpler to organize training for cooperatives than for individual businesses. Furthermore cooperatives can help members secure access to credit by offering loan security and established credit histories. Cooperatives also provide greater buying and selling power to their members.

On the other hand, it was also stressed that individual businesses in Rwanda appear to offer more incentives to workers than cooperatives. Separate businesses offer a more direct and individualized profit motive which tends to encourage greater efficiency and productivity.

Finally it also came to light during the MAPS dialogue sessions that some individual businesses thought they were ineligible for USAID-sponsored training activities at IWACU because they do not belong to cooperatives.

V. ACTION OPTIONS

A series of action options were developed as approaches to overcome the core problems outlined above. The MAPS Team considers that the following five action areas should be high priority for any USAID initiatives in the private sector in Rwanda:

A. Policy Reform

B. Export Promotion and Diversification

C. Credit and Equity Finance

D. Private Sector Associations and Support Groups

E. Business Skills Training

The issues associated with these action areas and specific strategy recommendations are presented in the paragraphs which follow.

A. Policy Reform

USAID became one of the first donors to be closely involved in private sector policy reform in Rwanda with the introduction of the PRIME (Policy Reform Initiative in Manufacturing and Employment) in 1987. In that project USAID played a pioneer role in working with the GOR to analyze and adjust macroeconomic and sectoral policies affecting private sector development in Rwanda.

Under PRIME initiatives the Government has adjusted the investment code, rationalized tariff policy, and has begun to introduce new reform measures in the areas of administrative reform, small business set-aside program, a national investment structure and streamlining of business registration procedures.

Despite the policy initiatives begun under the PRIME, the private sector policy environment is still not favorable. Unless it is improved most initiatives in the private sector will not succeed. The GOR has resisted policy reform advice of many of the donors but recent policy dialogue with the

Government suggests that GOR is now becoming more open to the concepts of policy reform and liberalization.

Recent AID Washington guidelines for priority countries in Africa stressed removing policy impediments to private sector growth as a critical short-term objective. An important medium-term objective is to improve the working of competitive markets. Both of these objectives are relevant to policy environment in Rwanda.

Key policy areas identified in the MAPS/Rwanda which require further USAID attention are: (1) exchange rate policy; (2) protectionism and import substitution bias; (3) price controls; (4) taxation policy; (5) hiring procedures; and (6) business registration procedures. These policy issues, followed by strategy recommendations, are discussed in turn below.

Overall Policy Recommendation:

USAID should continue to support private sector policy liberalization through the end of the PRIME Project and beyond.

(1) Exchange Rate

The Rwandan franc is currently overvalued by about 35% in real effective terms according to the IMF. The IMF's analysis is also confirmed by the current balance of payments deficits, the serious shortage of foreign exchange reserves (two months of import cover), and the existence of a black market which offers about a 37 percent premium for foreign exchange compared with the official rate.

The overvalued franc has profound implications on numerous private sector initiatives. Until it is adjusted many private enterprise activities will be thwarted. The main effects of an overvalued exchange rate are well known -- it encourages imports and reduces the competitiveness of exports. Eventually it can lead to a depletion of foreign exchange reserves, which in turn can cause severe shortages of vitally needed imports such as spare parts. A competitive exchange rate would reduce Rwanda's costs of production, encourage exports, and set the stage for a reduction in import tariffs and a liberalization of the import licensing system.

Strategy Recommendation

USAID is not likely to become the major donor advising the GOR on exchange rate policy. Nevertheless, given the major impact that the overvalued currency is having on exports and the availability of foreign exchange, **it is recommended that USAID support the IMF and the World Bank in their encouragement of a currency devaluation.** PRIME Phase III tranche releases or other program support initiatives should be dependant on exchange rate action.

(2) Protectionism and Import Substitution Bias

Many of the large firms in Rwanda are heavily protected against imports by high import tariffs and restrictive import licensing policies which result in effective rates of protection up to 200 percent. The activities protected include beer manufacturing, cigarettes, matches, sugar, soap, plastics, and corrugated iron among others.

The high levels of protection were introduced as part of an "infant industry" strategy to assist local industries in the early stages of production. In principle, these levels of protection should be scaled back as the "infant grows up". In reality the levels of protection offered to industries in Rwanda have rarely been reduced. One of the factors making the removal of protection difficult has been the overvalued currency, which makes imports cheaper.

High levels of protection can encourage uncompetitive "coddled" industries, which often are voracious consumers of foreign exchange, and which force domestic consumers to pay far above world prices for their products.

Strategy Recommendation

USAID should focus its private enterprise assistance efforts on efficient firms which are not heavily shielded by import protection. Most small firms and all export oriented firms would therefore be targeted for assistance. Efforts could also be made through the PRIME project to encourage the GOR to introduce a more rationalized and reduced external tariff. The benefits to the country from the above approach include improved allocation of resources, more positive foreign exchange impact, and lower prices to consumers.

(3) Price Controls

In an effort to contain inflation and to discourage high monopolistic prices, all products in Rwanda are subject to price controls. Margins are fixed by the Ministry of Finance at 15% for producers and wholesalers, and at 25% for retailers.

The price control policy has several flaws. First, there are no clear reasons why retailing requires a higher margin than other economic activities in Rwanda. In fact, many of the dialogue sessions with the private sector revealed that retailing is one of the easiest and least risky ventures in Rwanda; higher margins are probably not required to encourage private participation in this activity. Second, since the pricing system is "cost plus" there is no incentive to minimize costs; high unit production costs can be approved and passed on to the consumer. Therefore the system is not providing an incentive for efficient methods of production. Third, the margins permitted are probably not high enough to encourage the development of new technologies or innovation which require attractive returns to offset costs of development and research. Finally, price controls may be unfair in that administrative constraints make it difficult if not impossible for the Government to administer the controls evenly for all products and all firms across the country.

Strategy Recommendation

Because of the major flaws in the pricing policy which were outlined above, **it is recommended that USAID, along with donors such as the World Bank, encourage the government to liberalize prices on the vast majority of products in Rwanda.** Similar to the Ghana price liberalization program (Ghana reduced price controls from 2,000 items to five) Rwanda should be persuaded to reduce prices on all but a small list of strategic items, or goods for which the government wants to regulate monopoly pricing (e.g petroleum, electricity, telephone etc.). Unless prices are decontrolled, Rwanda will find it difficult to attract new foreign investors. Moreover incentives will not be attractive enough to encourage Rwandan entrepreneurs to invest in most activities outside of retail trade.

AID might consider pricing reform as a condition precedent to its upcoming private sector project in Rwanda. By pressing for government policies that do not distort prices nor stifle incentives, AID will be promoting policies that allow private markets to operate more freely.

(4) Taxation Policy

There are nine types of national taxes and six types of local taxes making the net effective business tax rate well above 50% and placing Rwanda among the highest business taxing countries in Africa. Small and micro companies in the private sector survey considered taxes to be the single most important factor having a negative effect on their business performance.

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This demonstrates how pervasive the tax system is, because many of these firms are unregistered and normally would escape the "tax net".

Strategy Recommendation

USAID should support efforts by the government to simplify the tax system, encouraging lower business taxes as a stimulus to productivity. The GOR should attempt to broaden the tax base through consumption-oriented taxes such as excise taxes and value-added taxes, as opposed to heavy business taxes which discourage production and investment. If business taxes were reduced, enterprises would have a better incentive to become registered and join the formal sector.

(5) Hiring Procedures

In order to hire skilled and semi-skilled full-time labor, employers in both the private and public sector must inform the Ministry of the Fonction Publique of any openings. The Ministry has sole authority over the hiring of personnel in both sectors and acts as a clearinghouse. The Ministry provides the employer with a list of names from which to choose the employee. The civil service has first priority in the allocation of labor, parastatals have second; the private sector has third priority. This inflexible system is biased against obtaining the most qualified people in the private sector and severely limits private sector competitiveness.

Strategy Recommendation

The current hiring policy needs to be reformed to give private firms control over hiring and firing decisions, consistent with national laws against discrimination because of race, ethnic group, age or sex. **Discussion of reform of the hiring law should be part of AID's ongoing policy dialogue with the government and studied under the project PRIME.**

(6) Business Registration

All businesses must gain approval from various government agencies before they begin legally operating. The initial documentation request for an "autorisation d'installation" from the Ministry of Industry is typical of the process: a detailed plan and analysis of the projected business is required including a market study, income statement and balance sheet, and an explanation of purpose, method, and technology to be used. This information is very similar to what a bank might ask of a loan applicant. A total of seven steps may be required for even the smallest projects. Such procedures do not accurately reflect the level of skills and the market research capacities of the country. Moreover, they act as a disincentive to investment, or at a minimum, as an incentive for many entrepreneurs to remain in the informal sector.

Strategy Recommendation

USAID should press for dramatic streamlining of registration procedures through its ongoing efforts under the PRIME project. The registration procedures should be streamlined into a quasi-automatic "one-stop" registration process. Cost-benefit analyses should be left to the entrepreneurs taking the commercial risks. Such a policy would allow more free market entry of firms and would yield more capital formation. Small firms would benefit from registration by becoming more eligible for credit, and gaining access to other formal status privileges such as import and export licenses. The government would gain by being able to collect additional tax revenue.

B. Export Promotion and Diversification

Low prices for Rwanda's major export commodities, coffee and tea, have caused a steep decline in export earnings. Official exports accounted for only 6.5% of GDP in 1988. The merchandise trade deficit rose to 13% of GDP in 1988, twice the total export receipts for that year. Rwanda imports the equivalent of 40% of its export earnings from African countries in the region; by contrast, exports to African countries represent only one percent of official Rwandan exports. Ironically two-thirds of the firms surveyed in the private sector survey thought that the regional market in African countries offered the most profitable export market.

Clearly, obstacles are preventing Rwandan firms from penetrating potentially profitable export markets. According to Rwandan firms surveyed, the biggest constraints to exporting are lack of market information, export taxes and export procedures. Exchange rate distortions have also made it difficult to export as Rwandan producers have found their products overpriced compared to other substitutable goods.

In addition to expanding exports, Rwanda needs to strongly diversify export products. Currently Rwanda relies on coffee and tea for over 90 percent of its export earnings. When the prices of those two commodities collapse, as is currently occurring, the country is faced with a major shock. To reduce the risk of such external blows, Rwanda should encourage the export of non-traditional exports. **Possible new exports include hides and skins, blankets, high value fruits and vegetables, and agro-processed goods such as fruit juices.**

Recently, countries such as Kenya and Ghana have undertaken successful export promotion campaigns. Countries in the Far East have also embarked on such schemes. Typically a successful export promotion campaign includes many of the following measures:

- Competitive Exchange Rate
- Reduced Export Taxes
- Targeted Export Credit
- Reduced Import Duty
- Foreign Exchange Retention Accounts
- Streamlined Exporting Procedures
- Export Market Research
- Export Promotion Agency

Several developing countries have also had success with the introduction of Export Processing Zones (EPZs) to encourage investment, exports, and employment. Mauritius, Hong Kong, the Dominican Republic, and Costa Rica are among the countries which have introduced successful EPZs. Several African countries, including Togo, Cameroon, Cape Verde, Kenya and Madagascar, have recently introduced EPZ legislation. Most of the EPZs export labor-intensive manufactured goods such as garments. The main incentives offered under an EPZ regime are:

- Import and Export Duty Reduction or Relief
- Corporate Income Tax Reduction or Holiday
- Accelerated Customs Procedures
- Foreign Exchange Accounts
- Freedom to Hire and Fire

Strategy Recommendation

In its longer-term private sector strategy AID may wish to assist GOR to introduce an export promotion and diversification program with many of the components outlined above.

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If the policy environment and exchange rate were to dramatically improve in Rwanda, the feasibility of an EPZ might also be explored.

C. Credit and Equity Finance

Most Rwandan companies, particularly small ones, receive no external financing from commercial banks, development banks, or credit unions. Over 90% of the firms surveyed received no formal credit. Most firms are financed solely from their own capital resources. Banking formalities, security requirements, and high interest rates restrict access to credit in Rwanda. For small, unregistered firms the problems are particularly onerous as their lack of land and unregistered status make access to formal credit nearly impossible.

There is little business borrowing, though banks such as the Banques Populaires have high levels of liquidity. In addition to the low levels of formal lending, very little informal business lending takes place. These findings suggest that there is a great potential for the financial sector to meet the financial needs of Rwandan firms. Higher levels of business lending should lead to greater investment, increased employment, and higher economic growth.

Strategy Recommendation

Efforts should be made in the upcoming private sector project to assist small businesses to gain access to credit. Some levels of success have been achieved in Rwanda by channelling credit to small businesses through cooperatives and business associations which can offer guarantees, collateral and credit histories to fulfill banking requirements. These opportunities should be explored further.

AID/Kigali could provide training in its upcoming private sector project to assist small-scale entrepreneurs in filling out loan applications and getting through bank formalities.

AID/Kigali should also consider training bank officials to better meet the needs of small businesses. An AID project in Kenya was successful after a long gestation period in training bank officers to tailor lending procedures to meet the needs of small business. AID/Kigali may wish to consider introducing a similar scheme with the Banques Populaires.

Efforts have been initiated under the PRIME project to introduce a venture capital fund called the "Structure Nationale d'Investissement". The proposal appears to offer some potential, provided that both the management remains independent of Government interference and that the projects targeted for investment have high enough rates of return and quick enough payback periods so that private investors would be interested in taking up shares in the fund.

Regarding credit guarantee schemes such as the "Fonds Special de Garantie", interventions by AID in this area are not recommended. This fund has not been successful in Rwanda because bureaucratic procedures bogged down loan applications; banks had little incentives to supervise loans; borrowers had little incentive to work hard to pay back the 80% guaranteed loans; and repayment rates are low.

Because of limited development resources in Rwanda, AID should not directly fund lines of credit or guarantee funds in its private sector projects. Instead it should leverage it resources by providing studies and suggestions which then might be financed by other donors such the case with the "Structure Nationale d'Investissement".

D. Private Sector Associations

Private sector associations are not meeting the needs of a majority of businesses in Rwanda. Membership in the Chamber of Commerce is mandatory; there are membership dues and additional tax liabilities associated with becoming registered with the Chamber. Consequently, 62 percent of small firms do not belong to associations, while 84 percent of large firms are members of associations mainly because they feel obliged to join.

A majority of firms sampled in the private sector survey that did not belong to private associations explained that they were not members because they believed that no organizations provided them with useful services. Firms are interested in associations supplying them with information on export markets, assisting them to gain access to credit, providing training and technical assistance, or lobbying the Government.

The Chamber of Commerce was rated as effective by only 48 percent of those members surveyed. The association receiving the highest effectiveness rating from its members was KORA, an artisanal business association (64%). During the private sector dialogue sessions, the question was raised by the MAPS team why KORA received a rating higher than the other associations. Several of the private sector leaders shared the same opinion: KORA was organized by the members themselves and was designed to meet their own needs.

Strategy Recommendation

USAID should help business associations become more effective in providing credit and market information and training to their members. Technical assistance, in-service training, short courses, and seminars are all possible avenues of training assistance that could be channelled through associations.

Based on the lessons learned from the successful KORA formula, AID should probably not try to organize any new private sector organizations but should work with existing organizations or assist entrepreneurs who have decided to organize a new organization to represent their own interests.

Given the poor experience the UNDP has had with the Chamber of Commerce, it would not be advisable for AID to get involved in assisting the Chamber of Commerce. The Chamber would have to be dramatically re-organized, with a shifting of emphasis from controlling to assisting the private sector, before AID assistance could be useful to private sector members of the Chamber.

Training

Based on the results of the private sector survey and the dialogue sessions, it is clear that skills development should be a high priority for any private sector development strategy in Rwanda. Lack of skilled labor was identified as the second most important resource constraint facing large firms in Rwanda. Among the critical areas needing improvement are management, accounting, and financial analysis skills. Small firms also need help with specific tasks such as preparing loan applications, registering their firm, etc.

Despite the clearly recognized need for training of Rwandan entrepreneurs, Rwandan firms surveyed gave a relatively low preference to personnel development and training among their priorities for investment in the firm. One of the explanations for this provided during the dialogue sessions was that many Rwandan firms are reluctant to invest in an employee's training when there is no guarantee that the employee will stay with the firm. Another explanation provided was that many firms are used to getting training for free.

One of the issues raised during the dialogue session by one of the larger private firms was that they thought that their firm was ineligible for training being offered at IWACU because they were not a cooperative. Recommendations on this and other training issues are presented below.

Strategy Recommendation

AID should give high priority to training in its private sector intervention strategy. Training should be provided to small businesses which generally are in most acute need of technical support. Topics to be included in the training could include: basic management techniques, accounting, and finance. Specific enterprise problems could also be tackled in the training program such as credit applications and assistance with the registration process.

Concerning funding of the training, it would be advisable to ask the firms to pay for a percentage of the training costs, perhaps 50% for larger firms and about 25% for smaller firms. This would encourage firms to participate in training only if they felt the training is meeting their urgent personnel development needs.

Based on previous training experience in Rwanda, it is recommended that when possible, AID deliver its private sector training through existing business organizations and cooperatives. These kinds of organizations allow for easier and more cost-effective delivery by relying on their existing organizational networks. Both cooperatives and individual businesses should be eligible for training as long as it can be channeled through an existing organization or cooperative.

VI. METHODS OF APPROACH

A. Commitment to Ongoing Dialogue

USAID has taken the lead in initiating contact and dialogue with the local private sector. On several occasions, private sector officials remarked that this was the first time a bilateral or multilateral organization had systematically approached the organized private sector or specifically focussed on private sector needs in its strategy. USAID should commit itself to the process of review, analysis, and dialogue that was initiated under MAPS; it will help to identify private sector initiatives that USAID can support.

B. Flexibility in Approach

Because the private sector is dominated by the rural and informal sector, the vast majority of the private sector is not meaningfully represented by associations. USAID should pursue formal and informal dialogue with the rural and microenterprise sectors as well as maintain some contact with the modern private sector and with key Government agencies, building on the contacts established during the MAPS exercise.

C. Build on Current Contacts

USAID has made some excellent contacts in its study of the private sector. These should be developed and expanded. Specifically, USAID should continue to dialogue with the following:

- -- KORA
- -- JOC (Jeune Ouvriers Catholiques)
- -- AFAR (Association des Femmes d'Affaires Rwandaises)
- -- The Development Bank
- -- Banques Populaires
- -- Center for the Promotion of Small and Medium Enterprises

D. Keep Notes on Private Sector Meetings, Attitudes and Changes

The business environment is going through a period that will lead to some important policy changes. It will be useful to keep notes of meetings to track changes in attitudes and policies. Even during the six months of the MAPS exercise some important changes in attitude were noted both in the public and private sector.

E. Update Private Sector Description and Diagnostic Survey

Now that USAID has allocated the time and resources to familiarize itself with the role of the private sector in the economy, it should periodically update its information and data base. The Mission now has access to the SPSS data base from the private sector survey and the capacity to analyze the data in response to further questions that may arise. The data base could be a useful tool for planning the upcoming private sector project or for identifying information such as priority training needs in specific sectors. The Mission should also conduct periodic sector surveys, particularly as strategy becomes more targeted.

VII. CONCLUSION

The Mission has developed a strong understanding of the role of the private sector in the economy; it has become acquainted with the major constraints to and opportunities for growth, and it has established good contacts with private sector officials. With this knowledge, the Mission is in a position to determine how the local private sector can help USAID achieve its goal and objectives as strategy unfolds for the next five years. The Mission is also now prepared to define its role within the context of donor community activities.

The MAPS team is of the opinion that that AID is now well equipped to implement a private sector development strategy in Rwanda, based on a solid base of information and project implementation experience in the private sector. Although there are a number of policy-related and geographic constraints facing the Rwandan private sector, there are still a variety of opportunities. Private sector initiatives will need to continue to focus on identifying policy constraints and finding ways of removing them so that private enterprise can expand. Given the large number of problems identified and the urgency of the situation, an action-oriented approach is recommended. USAID should attempt to work toward achieving tangible progress in critical areas so that its private sector interventions can have a catalytic effect.

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