# Getting the Best out of Regional Integration: Some thoughts for Rwanda

Jaime de Melo
University of Geneva
and
International Growth Centre

February 17, 2011

## Main points…

Rwanda is increasingly focusing on integrating into global markets through trade – because exports remains an untapped potential source of growth...

Exports are very concentrated and of short duration – underscoring the importance of the objective of diversification in the NES.

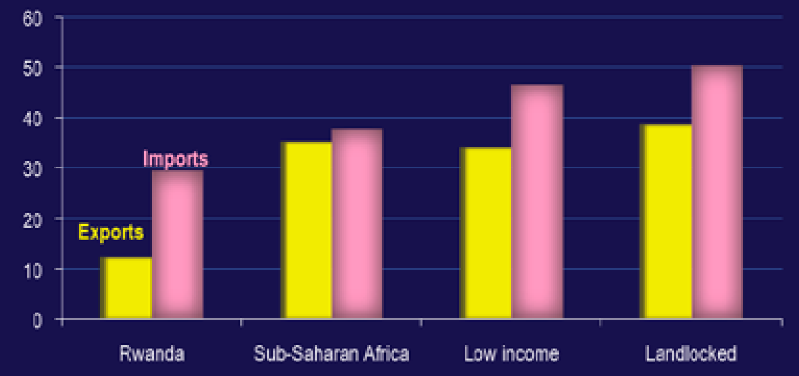
Rwanda has rightly sought regional integration through the EAC ... but adopting the common external tariff (CET) has been costly, NTBs are still rife, and costs of trade are still high.

So, to counterbalance these costs, Rwanda needs to push for 'deep integration' - negotiate for lower tariffs and reduce NTBs within the EAC.

...and keep a competitive real exchange rate, the key indicator of a country's competitiveness on world and regional markets

## Rwanda trades less in goods than most other countries… so trade provides an opportunity for growth

Trade as a share of GDP, avg. 2007-2008

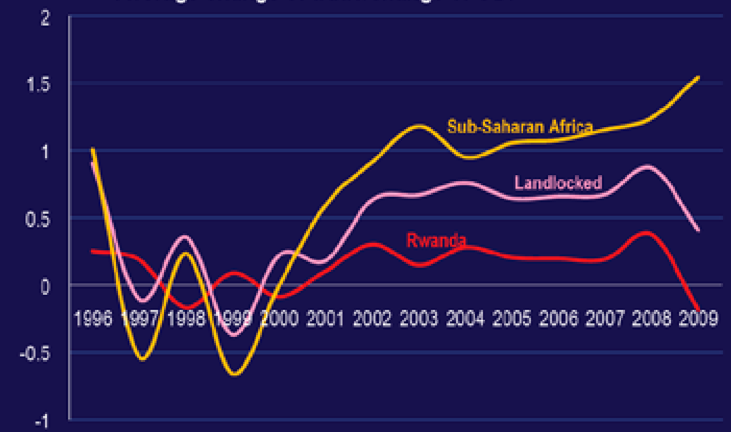



Qualifications: Services trade and informal trade are not included

Source: World Bank, World Development Indicators. Average 2007-2008 values. Landlocked represents the average value across landlocked developing countries excluding Rwanda.

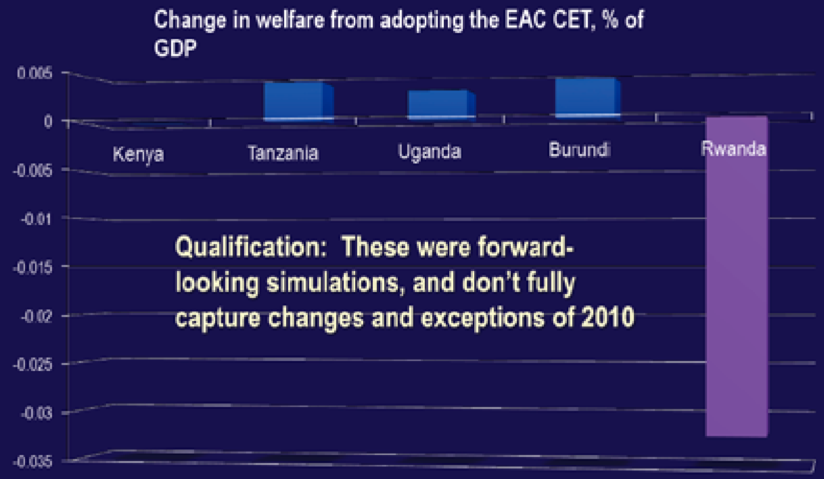
## … and because trade share in GDP is small, it contributes little to GDP

Average change of trade/change of GDP

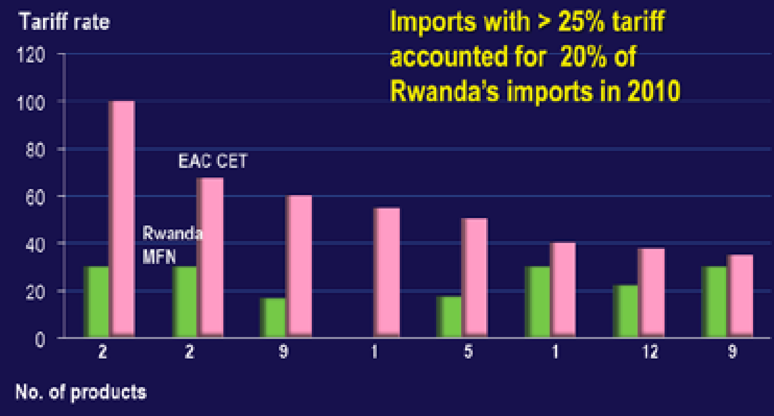



… an annual 10% growth of exports in Rwanda contributes about only about 1.2 percentage points of GDP growth instead of 4-5 percentage points

## Regional integration could propel trade … but early analysis suggested that Rwanda could actually lose from current EAC tariff regime



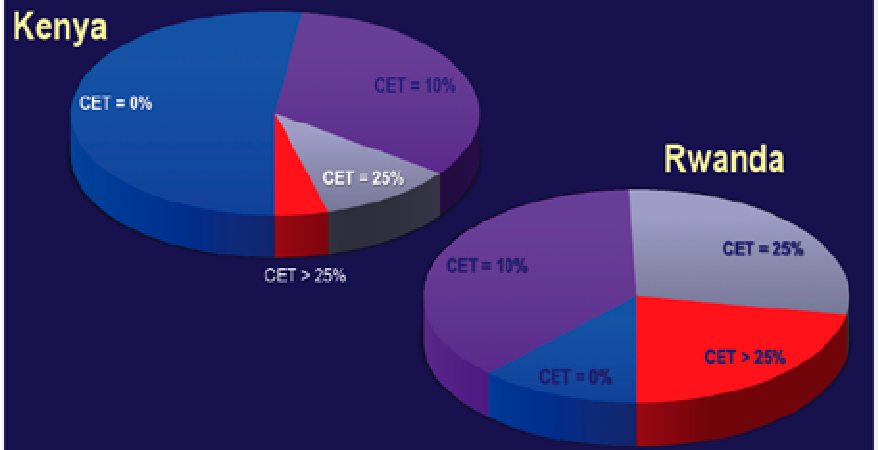

## The main disincentive arises from EAC tariffs on the "sensitive items list"




Source: Carrere and de Melo (2008)



## Rwanda imported a much greater share of its total imports over the high end of the CET from the SI list




Share of import volumes at selected tariff ranges, 2006

## Rwanda could leverage its position in the EAC to improve incentives to produce for export…

- …through reductions in disadvantageous levels of tariff protection
- …through removal of nontariff barriers (NTBs)
- …through greater attention to services

## Why?… *Incentives* that result from the combination of tariffs, transport costs and NTBs

Tariffs and NTBs encourage firms to sell at home rather than sell abroad… and aggravate the disadvantages of being landlocked.

| Profits of exporting = | | Profits selling at home = | |
|---|---|---|---|
| + value of sales | 100 | + value of sales | 100 |
| - transport costs | -20 | + transport costs | 20 |
| - NTBs in partners | -20 | + tariff | 10 |
| + tariff in EAC partner | +10 | + NTBs | 20 |
| ------------------------------ | --- | ------------------------------ | --- |
| = profits | 70 | = profits | 150 |



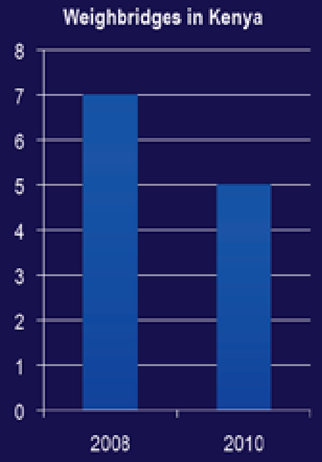
## Moving towards 'deep' regional integration

- The agenda for regional integration is both "at and behind the border" to overcome small markets and reduce the "width" of borders
- …to foster intra-industry trade that is key for EAC countries to benefit from the rise in fragmentation of production
- …by better VAT administration, less restrictive Rules of Origin, better approach at setting and harmonizing standards, and one-stop border posts…



## Progress on NTBs is in the right direction, but slow…

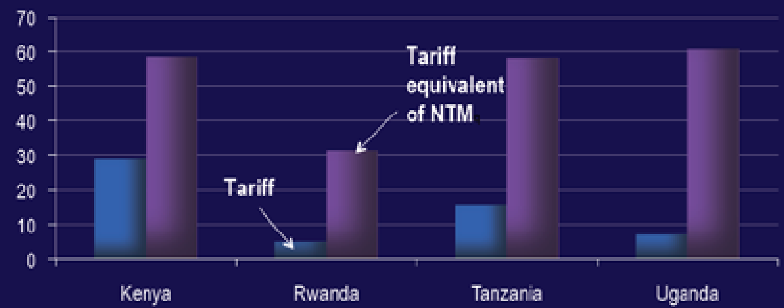
| Nature of NTB | Status |
|---|---|
| Border Clearances | Some one stop border posts and 24/7 operations, ICT connectivity improved; delays greatly reduced |
| Weighbridges | Continued major source of delays |
| Port Clearances | Modernization of Mombasa Port has greatly reduced delays; Limited cargo handling facilities at Dar Port still causing delays |
| Roadblocks | Roadblocks still lead to delays and increase the cost of transport through bribery |
| Poor Infrastructure | Most part of the Northern and Central corridors are paved and smooth, however driver fatigue still leads to numerous accidents |




Source: PSF and MINICOM NTBs Report 2010



## …and tariff equivalents of NTMs in the EAC are higher than tariffs




| Kenya | Rwanda | Tanzania | Uganda |
|---|---|---|---|
| Prohibitions affecting 16 tariff lines | Non-automatic licensing affecting 52 tariff lines | Technical regulations affecting 4296 tariff lines | Technical regulations affecting 30 tariff lines |

## Removing NTBs at regional level…

- So far some efforts at monitoring and reporting (to meet the 3 objectives of transparency, non-discrimination and proportionality)
- …but no progress yet at eliminating those in category "A" i.e. those identified as easy to remove creating no political hurdles and impede trade substantially
- …and signs of discretion
- Carry out a regulatory impact analysis before modifying or introducing new NTB

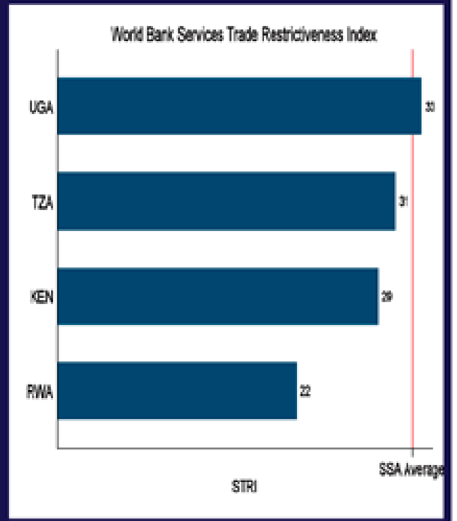


## THE INCENTIVE REGIME…Services

There are NTBs in services, though not high according to indices for EAC (low value means few restrictions)

Services sales from Rwanda are large and could grow as connectivity and cost of IT falls and costs (and reliability )of electricity falls

The plight of landlockedness is much less (or nonexistent) for services that do not involve the movement of the providers




## Creating an Open Services Market in the EAC by 2015

- ***Access to cost-effective services affects performance in the rest of economy and international competitiveness.*** In Kenya, Rwanda, Tanzania and Uganda, firms that use accounting, legal and engineering services, whether externally outsourced or provided in-house, have higher average labor productivity than firms without professional services linkages
- ***Openness to trade in services has to be accompanied by an appropriate regulatory framework***
- Assembling knowledge on regulation is delicate and sector-specific. Requires:
  - A consultative mechanism to collect, analyze, and diffuse knowledge on services regulation and reform
  - A mechanism to identify alternative options based on experiences of other countries (neighbors; BRICS, high-income countries/OECD, etc.)
  - A vehicle to support development of national and regional services trade strategies and to monitor implementation

## Final point… The real exchange rate is key to export drives

**Avoiding overvaluation:** Early success at exporting (or mobilizing donor finance) can drive up currency value – and raise price of exports.

- overvaluation leads to slow productivity growth

**Maintain competitiveness:** Competitive exchange rate may foster growth including learning by doing associated with productive activities for exports

- "growth accelerations" and 'successful' trade liberalizations were preceded or accompanied by a devaluation of the real exchange rate
- Country experiences: Korea (1964-mid-1970s), Chile 1982-92, China post -1994

**Conclusion:** Managing the real exchange rate is essential but is difficult because of large donor inflows…and because of exchange rate policy of trading partners.

## Conclusions

- Today, the prices of selling on market for exports compared to the prices of selling domestically discourage exports … and reversing these incentives is a high priority…
- High common external tariffs are a key incentive that puts Rwanda at a particular disadvantage, so the coming renegotiation of the CET offers an opportunity to adjust the incentives to Rwandan export activities (SI list)
- Continuing work on NTBs will reduce costs to exporters – possibly by enlisting the private sector in the monitoring efforts and make it profitable to switch away from producing for the domestic market
- And always keep a close eye on maintaining a competitive real exchange rate