

Firm capabilities: Rwanda's trade performance and policies to create export dynamism.

Professor Ricardo Hausmann

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Ricardo Hausmann

Professor Ricardo Hausmann is Director of the Centre for International Development and Professor of the Practice of Economic Development at Harvard University. Previously, he served as the first Chief Economist of the Inter-American Development Bank (1994-2000), where he created the Research Department. He has served as Minister of Planning of Venezuela (1992-1993) and as a member of the Board of the Central Bank of Venezuela. He also served as Chair of the IMF-World Bank Development Committee. He was Professor of Economics at the Instituto de Estudios Superiores de Administracion (IESA) (1985-1991) in Caracas, where he

founded the Center for Public Policy. His research interests include issues of growth, macroeconomic stability, international finance, and the social dimensions of development.

Professor Ricardo Hausmann provided insights on the role of firm capabilities and a country's product space in economic growth. Knowledge is accumulated stepwise, transitioning from simple to complex products. Making the right choices and providing a welcoming business environment will accelerate the process. Professor Hausmann indicated areas of potential strategic interest to Rwanda as well as important steps to take in order to attract investment and foster knowledge creation.

The Macro picture of Rwanda

After four decades of virtually no increase in per capita income, the rate of growth since 2000 is impressive. Rwanda is one of the best performing economies in the developing world, lagging only major resource exporters. Income per capita nonetheless remains below LDC average. Investment has been on the rise, inflation has remained moderate and exports have increased significantly – including export of services. The overall level of exports however remains low relative to countries of comparable per capita income. Exports remain concentrated in non-complex products in geographically distant markets while nearby markets demand more complex products than Rwanda can produce.



IGC Rwanda

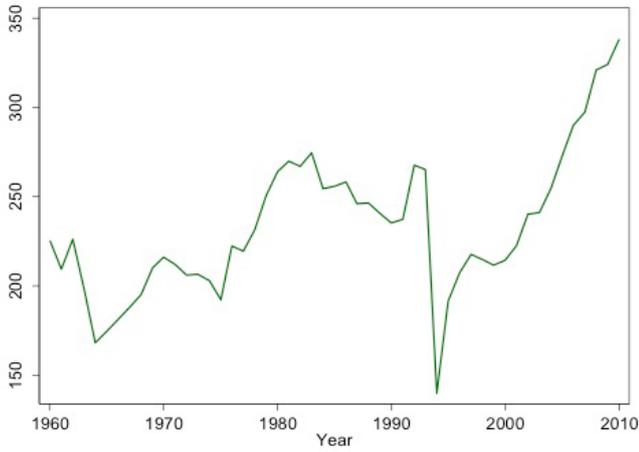
For enquiries about the IGC Rwanda programme, please contact:
Jonathan Argent, In-Country Economist, joanthan.argent@theigc.org
Michele Savini Zagrandi, In-Country Economist, michele.savini@theigc.org

www.theigc.org

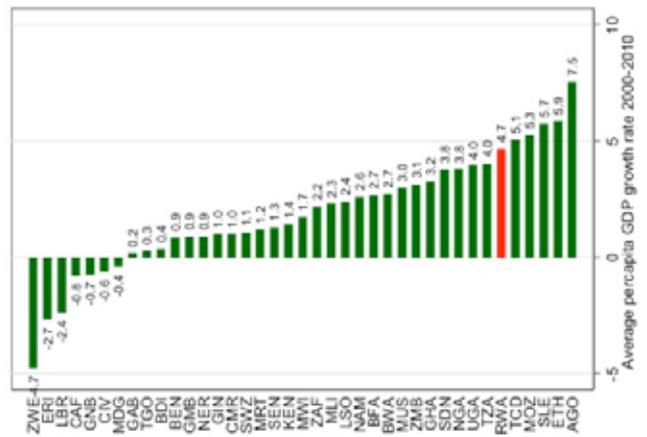
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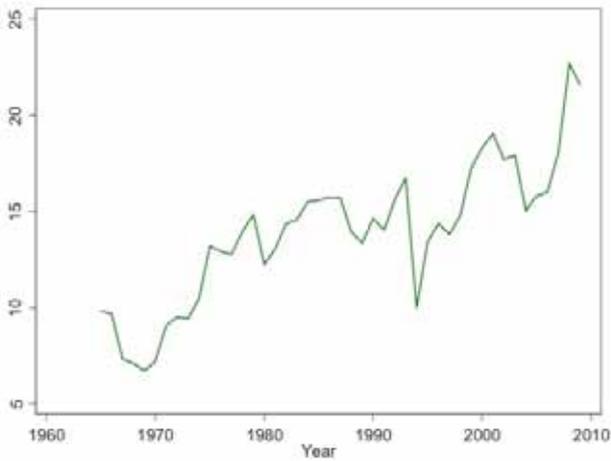
GDP per capita in constant USD



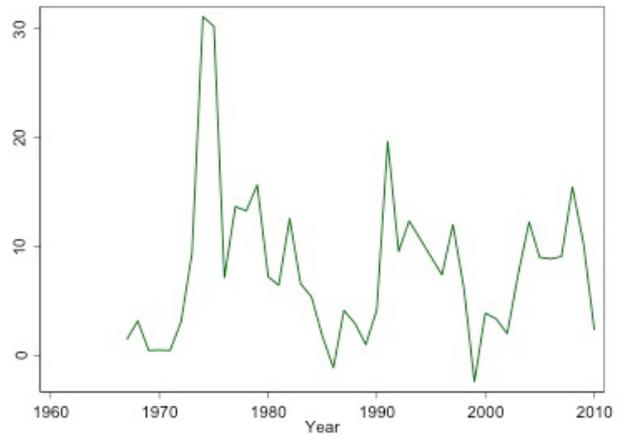
Average pc GDP growth 2000 - 2010



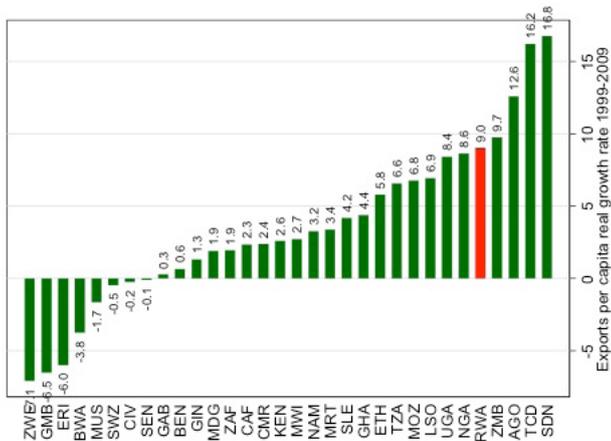
Gross fixed capital formation as % of GDP



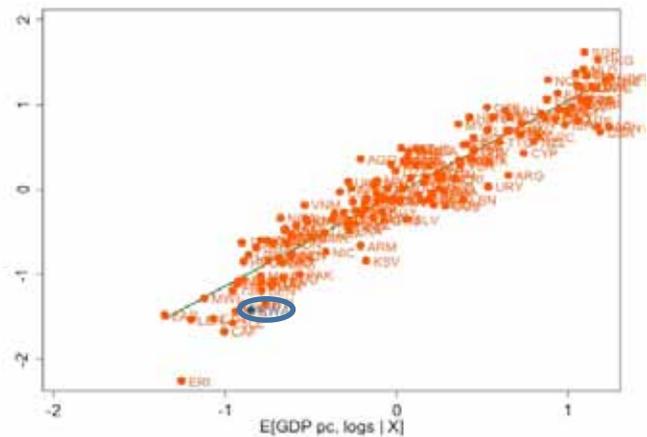
CPI inflation, annual percentage change



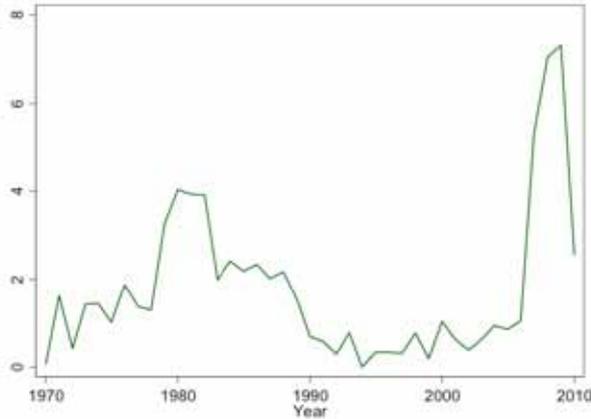
Growth in exports per capita 1999 - 2009



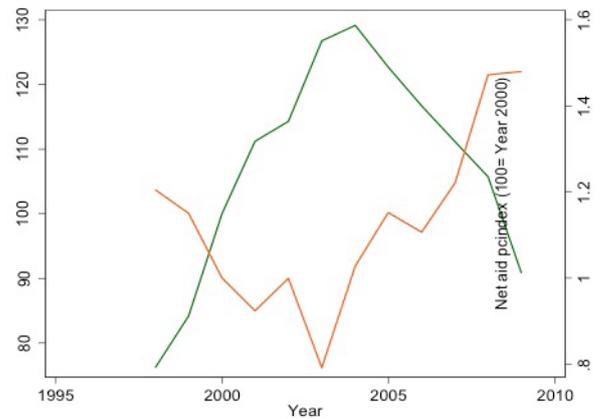
Exports in relation to GDP



Net FDI inflows per capita



Real exchange rate and aid flows



FDI has shown little dynamism as shown in the green graph on the left below. Aid flows (in red below) have increased and are associated with appreciation of the real exchange rate to appreciate (blue – down means appreciation) and making exports more difficult.

is expected to grow as a result. Its location in the product space however is tricky and strategic choices on where to diversify are important.

The secret of growth

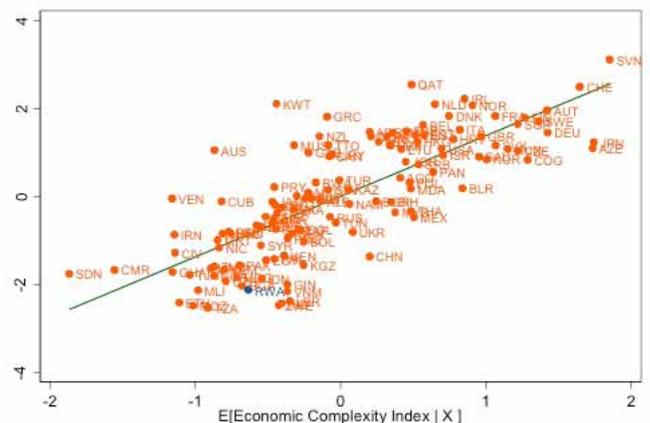
Countries that have more knowledge can make more complex products; however, they do not stop producing simple products. This results in many countries producing similar simple products and few countries diversifying in more complex products. It is possible to measure how similar products are to each other – and implicitly how similar the capabilities required to produce them are; the more similar are the capabilities needed to produce two different products, the easier it is to “jump” from one to the other. Thinking of the product-space as a forest is illustrative: monkeys in a forest can only jump to nearby trees, the same way a firm can only diversify into products that require similar capabilities to what they already have. The more capabilities a country has, the more diversified the products it can produce and the faster it is likely to grow. Speed of growth also depends on how well placed a country is in the product space: the more close products there are to its existing capabilities the faster it can diversify and therefore grow.

Given Rwanda’s high density and rapid population growth, it needs activities that are scalable such as manufacturing and business services. High transport cost will make manufacturing exports difficult in distant destinations. Local markets however present an opportunity if Rwanda can cater to demand for the more complex products. Two opportunities to be explored are food processing and construction materials – both are relatively close in capabilities to Rwanda position in the product space, and would move Rwanda closer to denser areas in the ‘forest’.

Real exchange rate and aid flows

Thinking of where to diversify is a strategic choice: a monkey can face two trees at the same distance, behind one is the desert, behind the other is a forest, there is a clear opportunity value behind industrial policy choices that can lead to faster or slower growth.

Growth and economic complexity



Implications for Rwanda

Rwanda has successfully expanded its product space in the last decade increasing the complexity of its knowledge (see the presentation slides for a graphical representation) and

Business services are already Rwanda’s second largest services export, Rwanda’s good business environment and its bilingualism make it a good candidate to serve central and eastern Africa.

Stepping up the game will require an active and well thought out industrial policy. Three activities the government should consider are:

