LASER Legal Assistance for Economic Reform

Rwanda Pilot Case Study: PDIA in practice during the LASER pilot - Foreign Direct Investment

DFID Legal Assistance for Economic Reform Programme

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Abstract: *This case study was developed as part of LASER's initial one-month pilot engagement in Rwanda. It explores how to take a problem-driven approach in supporting the Government and stakeholders to identify and deconstruct problems, in this case in relation to attracting sufficient foreign direct investment. Lessons learnt helped inform LASER's approach to investment climate and institutional reform, and the development of further case studies which are all part of a suite of LASER products on doing development differently.*

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Context

1. LASER (Legal Assistance for Economic Reform) is a DFID-funded programme aiming to improve investment climates in eight developing countries by helping to identify and solve commercial law and justice problems, as well as documenting and sharing lessons about how to do this. Problem- driven and iterative in nature, LASER supports partner governments to develop initiatives that are country owned and led. Its logframe commits to activities under broad outputs, but the specifics are determined at the country level with counterparts on a rolling basis.

2. In late 2014, following the Rwanda Minister of Justice clearly articulating the importance of and link between an effective justice system and an improved business environment, LASER undertook a scoping mission to Kigali. Potential areas were identified for exploring further, and a subsequent one-month LASER pilot was carried out in February 2015 with a resident adviser embedded in the Ministry of Justice (MINIJUST) to begin to identify problems that were holding back economic growth and where legal assistance had the potential to make a significant impact. This case study explains the problem identification and deconstruction process undertaken by the LASER resident adviser as the programme began to explore how best to do development differently on the ground.

Identifying the Problem[1]

3. The LASER resident adviser met with a range of stakeholders to brainstorm the main problems hindering economic reform – which legal assistance could help address. A number of key constraints were identified including poor infrastructure, small markets (due to a relative lack of regional integration in practice), a lack of appropriate incentives (e.g. tax and Special Economic Zone incentives), a poor regulatory framework etc. However, one that repeatedly emerged was that the Second Economic Development and Poverty Reduction Strategy (EDPRS 2) target growth rate (11.5%) cannot be achieved in the short to medium term by domestic measures alone and would require significant increases to Foreign Direct Investment (FDI).

4. There was clear evidence backing this up, as in absolute terms, Rwanda's FDI was $160 million in 2012, significantly less than levels in all neighbouring countries, with the exception of Burundi: DRC ($3,312m), Tanzania ($1,706m), Uganda ($1,721m) and Burundi ($1m)2. And in relative terms, Rwanda's FDI was equivalent to only about 2.3% of GDP, much lower than the sub-Saharan African average of over 4%, showing the extent of the challenge[3].

Deconstructing the Problem

5. First, it was important to understand, through meeting with the International Finance Corporation (IFC), why FDI was four times lower than expected given Rwanda's recent success in

[1] This case study draws out experiences during the pilot period of LASER in February 2014. A later case study on "contract management" draws out how the steps proposed during the pilot and outlined here, were implemented in practice. The views expressed are those of the authors and not any of the specific parties mentioned herein.
[2] UNCTAD, World Investment Report 2013
[3] UNCTAD, World Investment Report 2013

Doing Business (moving up the global rankings from 54th in 2013 to 32nd in 2014)[4]. The main reason appeared to be that Doing Business indicators focus on factors important to domestic Small and Medium Enterprises (SMEs), which aren't always the same as the broader investment climate factors important to foreign investors. So, for example, a number of the key infrastructure and interconnectivity constraints in Rwanda could deter foreign investors more than the operations of domestic SMEs. In addition, the Rwanda Doing Business indicator ranked the worst is "Trading across borders" (Rwanda ranked 162 out of 189 countries for this indicator in 2013) which is particularly important for foreign investors[5].

6. Second, LASER met with the African Development Bank (AfDB) who co-chairs the EDPRS 2 Sector Working Group (SWG) on Infrastructure with the Ministry of Infrastructure (MININFRA). The following issues were explored: Does economic growth really need more FDI, or can it in fact be driven by SME growth in Rwanda? AfDB is providing credit to SME's in response to access to finance being a constraint on the sector. However, the Doing Business indicator for obtaining credit is 13 for Rwanda, compared to the sub-Saharan Africa average of 113, suggesting access to finance is not likely the most binding constraint. Whereas in contrast, there was a consensus on the importance of FDI to economic growth in Rwanda, particularly at this point in time.

7. Third, it was important to meet the Rwanda Development Board (RDB) – the Government of Rwanda (GoR) lead negotiator – which is involved in all large FDI deals that involve government. The need to promote and manage FDI for economic reform was discussed and it appeared to also be of importance to RDB. Some years ago the GoR was not getting fair deals – due to much stronger legal and commercial advice on the private sector side. But in recent years that has started to change through strengthening RDB which now has specialist lawyers on a retainer through the Africa Legal Support Facility (ALSF). RDB has started to develop model contracts for (1) energy projects, and (2) mining concessions – areas in which they have the most deals. They are also developing contracts for (1) privatization and (2) Public Private Partnerships (PPP) and indicated they would welcome them to be reviewed and to consider if/how they could be replicated given the specific nature of those deals. It appeared to be the case that line ministries – who are responsible for management of contracts once a deal goes ahead – do not always have sufficient understanding of, nor the ability to effectively manage, the complex investment contracts. As significant amounts of FDI are directed to energy and mining sectors in Rwanda, this led to considering that MININFRA and the Ministry of Natural Resources (MINIRENA) could be the most in need for technical assistance support to help them understand and manage complex investment contracts.

8. Fourth, following the lead from RDB, in deconstructing the problem further with MININFRA it was clear they agreed that the contract management process was a critical limitation on FDI at present. However, they also raised the importance of strengthening the regulatory framework as development of privatization and PPP laws are underway, but there are still significant limitations with current legislation that deters FDI, such as the Company Law (No. 7 of 2009 and No.14 of 2010), Intellectual Property law (No. 31 of 2009) and Competition law (No. 36 of 2012).

[4] World Bank, Doing Business in Rwanda, 2013 and IFC discussion

[5] While Rwanda made trading across borders easier in 2014 by introducing an electronic single-window system at the border. Its rating rose to 157 for 2014 but it did not make any changes in 2015 and it subsequently fell to 164.

To understand how much this matters, the Private Sector Federation (PSF) – an independent institution – was consulted. The PSF agreed that the regulatory framework needed strengthening, that it was a significant problem for their members and they would welcome support in generating dialogue on the issues.

9. Fifth, a literature review provided the basis for rich discussions over the extent to which FDI was being crowded out by dominant companies[6]. An informed approach enabled stakeholders to share and explore views on the following issues: Why has privatization in Rwanda taken so long, is it because of state reluctance or the legitimate desire to avoid rushing privatization and making mistakes as has happened in some neighbouring countries? Is there a lag in FDI partly due to perception of investors, i.e. apprehension over the state's involvement in the economy? There were divergent opinions on these issues, but the problem deconstruction process helped stakeholders to hear contrasting views and to either affirm or re-assess their own perspectives. The problem deconstruction and solution identification process is illustrated on the next page.

[6] Institute of Development Policy and Management, N. Gökgür. Rwanda's ruling party owned enterprise: Do they enhance or impede development, 2012

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Illustrating Problem Deconstruction and Identifying Solutions

The problem	LOW FDI LIMITING ECONOMIC GROWTH											
Why?	Inadequate investment promotion	Small market and lack of opportunities	Poor infrastructure	Lack of financial incentives to invest	Poor regulatory framework				Poor GoR investment contract processes / management			
Why?	RDB unit not effective enough and/or challenge too large	Lack of regional integration	Low investment due to conflict and landlocked	Special Economic Zone and tax incentives currently inadequate	Lack of, or poorly drafted, legislation				RDB-MINIJUST-Line Ministries not negotiating, drafting or managing investment contracts well			
Possible solutions?	Provide capacity building to RDB unit	Support EAC, COMESA and CEPGL implementation	Support EDPRS 2 infrastructure projects	Further develop the Special Economic Zone and tax incentives	Support MINIJUST and others to identify and discuss further required laws		Support MINIJUST, RLRC and others to identify / propose legal amendments		Equip RDB and MINIJUST to negotiate and draft better investment contracts			Support MININFRA / MINIRENA with basic investment contract management tools
Feasible steps	Embed legal adviser in RDB	Support harmonization of laws under treaties	Embed legal adviser in MININFRA	Provide specialist SEZ and tax advice	Development of Privatization and PPP laws (RDB lead)	Others e.g. development of Company Law articles of association	Review Competition Law / Policy (IFC lead)	Others: e.g. Trusts Law and IP Law both likely need amends	Provide training on priority areas: construction, PPP, tax and privatization	MINIJUST more involved in investment contract processes	Support RDB and MINIJUST in developing model investment contracts	Develop basic investment contract management tools with training on use

Determining Feasible Steps

10. Various pathways to enhancing FDI were explored and the steps shaded in green in the diagram above were deemed feasible. It was only through iterative steps – trial and error – that the proposed solutions in red in the illustration above were not deemed feasible given other interests for the following main reasons:

    a. RDB's strategic investments unit receives (sufficient) support from ALSF and RDB's investment promotion unit does not require further legal (only commercial) support

    b. Harmonization of laws under treaty obligations is already underway and being led by the Ministry of the East African Community (MINEAC)

    c. Embedding a legal adviser within MININFRA would limit LASER's support for non-infrastructure related activities

    d. SEZ and tax incentives are already being supported by TradeMark East Africa (TMEA)

Proposed Way Forward

11. After exploring various economic reform problems, it was clear that enhancing FDI is critical to Rwanda's growth prospects. It was possible to deconstruct the problem and then identify two priority areas for LASER to strengthen: (i) Investment contract processes and management, and (ii) regulatory framework. Possible steps were discussed with the key stakeholders, and with the support of the champions, are planned to be feasible given the local environment.

Feasible Step 1: Strengthening investment contracts and management

12. The specific champions for reform are the RDB Strategic Investment unit, MINIJUST Legal Advisory Services, MININFRA Legal Department and the Institute for Legal Practice and Development (ILPD). As investment contracts are often the largest value, it's critical that MINIJUST be involved in the investment contract process. This could involve review/input into the energy, mining, privatization and PPP[7] model contracts. Draft Ministerial Instructions Governing Contracts are due to be operational in April 2014, and LASER could support their implementation in practice. There is also clear need to provide training on these priority areas and develop basic contract management tools for line ministries, in particular MININFRA. This is identified as a key priority and proposed feasible step.

Feasible Step 2: Strengthening regulatory framework

13. There is consensus that commercial laws need review and development, however, at present there is insufficient dialogue on the issue and so a lack of momentum for change. LASER could help build dialogue around review of the Company Law (No. 7 of 2009 and No.14 of 2010), Intellectual Property law (No. 31 of 2009) and the development of PPP and Privatization laws. Champions for reform are likely to include MINIJUST, RLRC, RDB (investment deals), MINICOM (trade and industry representative) and the Private Sector Federation.

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[7] Including assessing the extent to which model contracts for privatization and PPPs are feasible given the nature of the deals envisaged.