

# Using Trade to Grow: Lessons from International Experience for Rwanda

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October 28, 2010

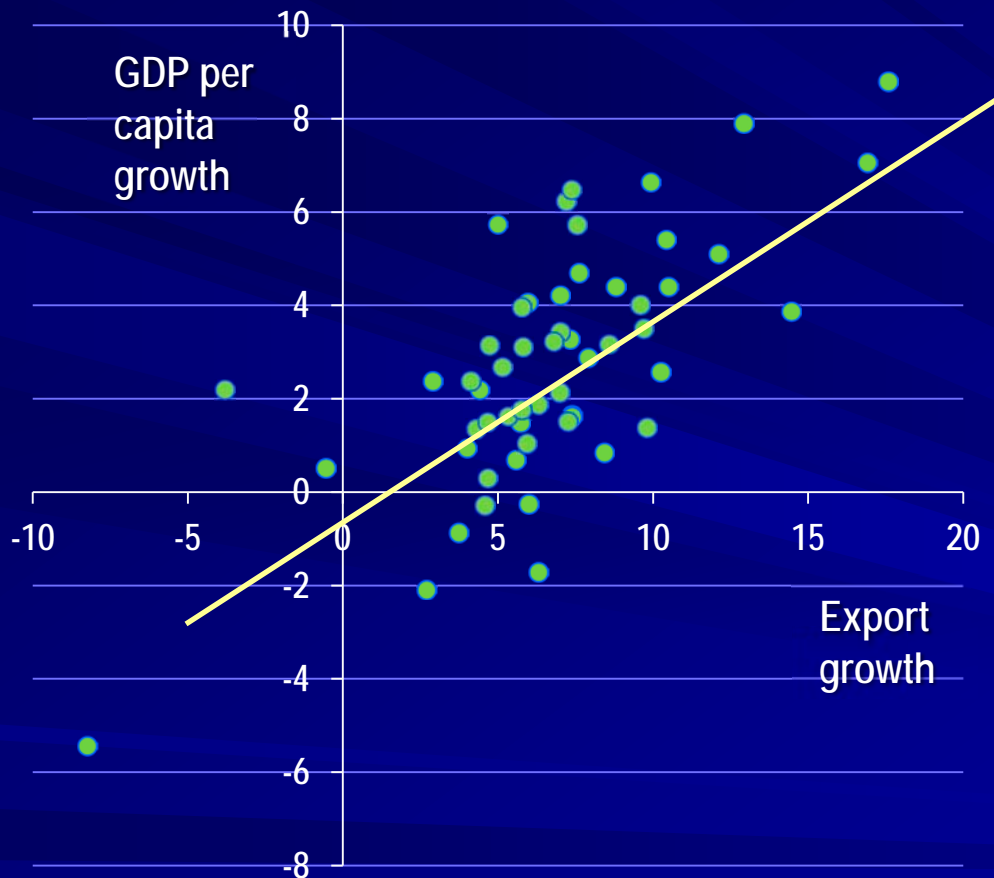
## Main points...

A key lesson of international experience is that international trade can be a driver of growth

...but trade remains an under-exploited opportunity for Rwanda – trade ratios for goods are low, diversification across products and geographic markets is low, and new exports seem to die quickly

International experience raises questions in four areas that might merit additional policy discussion: infrastructure, reducing trading costs, leveraging regional trade agreements, and management of real exchange rate.

# Rapid export growth is associated with rapid growth in regional incomes...



## Trade drives productivity

**Exports:** access to larger – and faster growing -- market

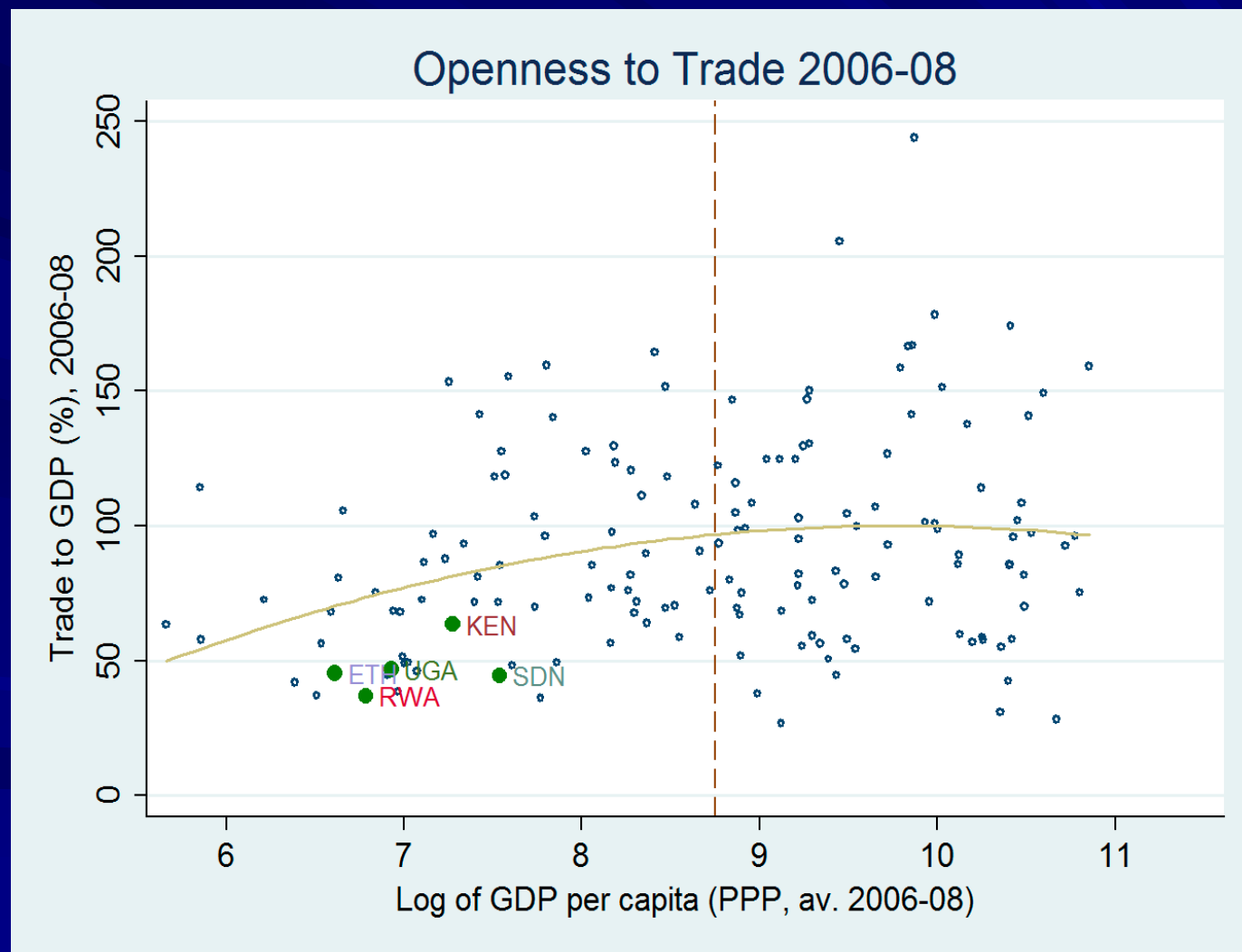
- Economies of scale → productivity
- Economies of specialization

## Imports

- Competition drives out less efficient firms -> productivity
- Cheaper inputs
- Products made with expensive inputs (R&D for poor countries; labor for rich countries)
- Variety

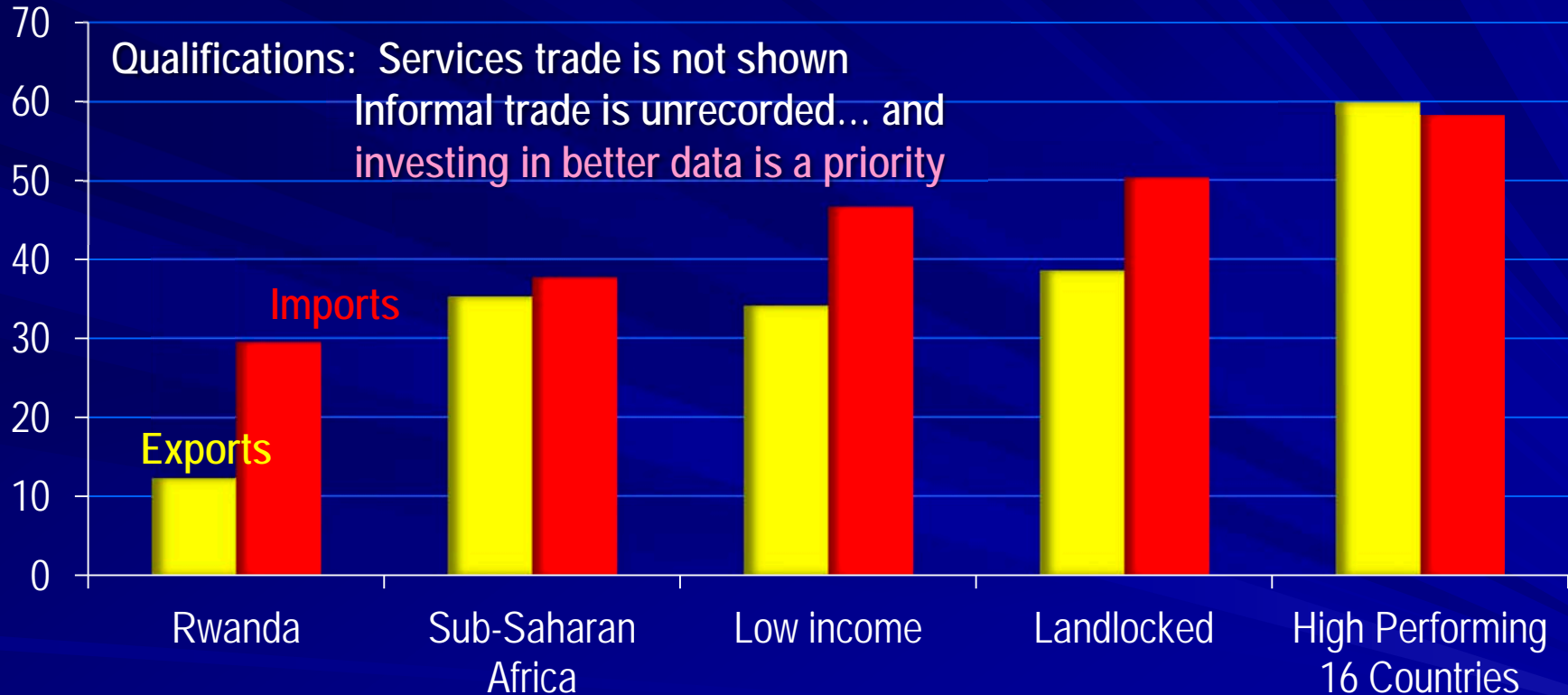
Source: World Trade Report, 2008 based on World Development Indicators. See also Winters, 2004; Spence, 2008; Cline 2004. The period is 1961-2008 and growth rates are averaged over five years intervals. The data represent the following non-overlapping groups: East Asia and Pacific, High Income, Europe and Central Asia, Latin America and the Caribbean, Middle East and North Africa, South Asia, and Sub-Saharan Africa.

# EAC countries still have much to gain with trade integration – trade is below the predicted level



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

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

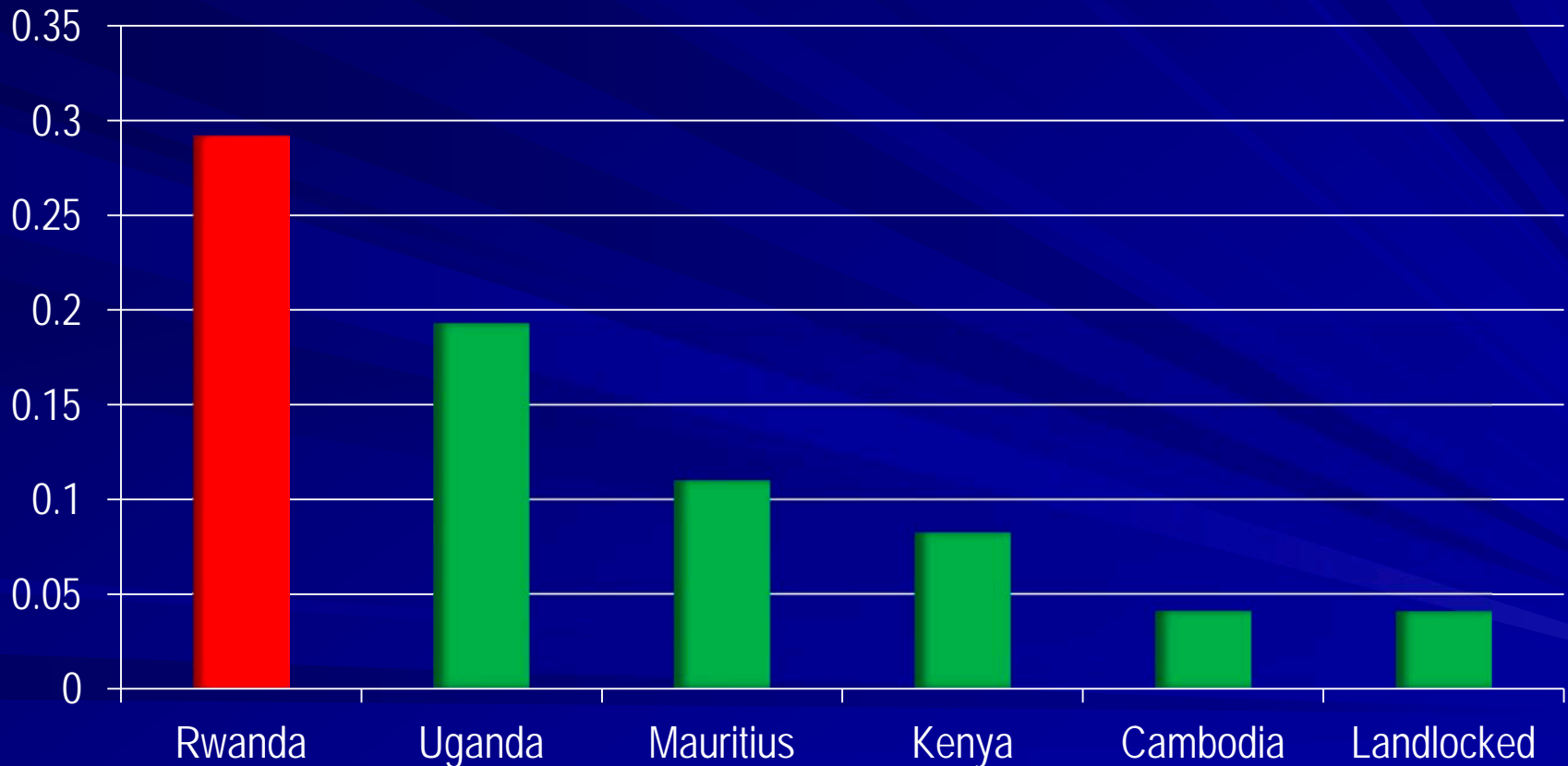


High performing countries were the fastest-growing in real GDP 1980-2006, and include Botswana, Burkina Faso, Cambodia, Chile, China, India, Indonesia, Korea, Malaysia, Mauritius, Pakistan, Singapore, Sri-Lanka, Chinese Taipei, Thailand, and Uganda.

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

# Rwanda is over-reliant on a few export products...

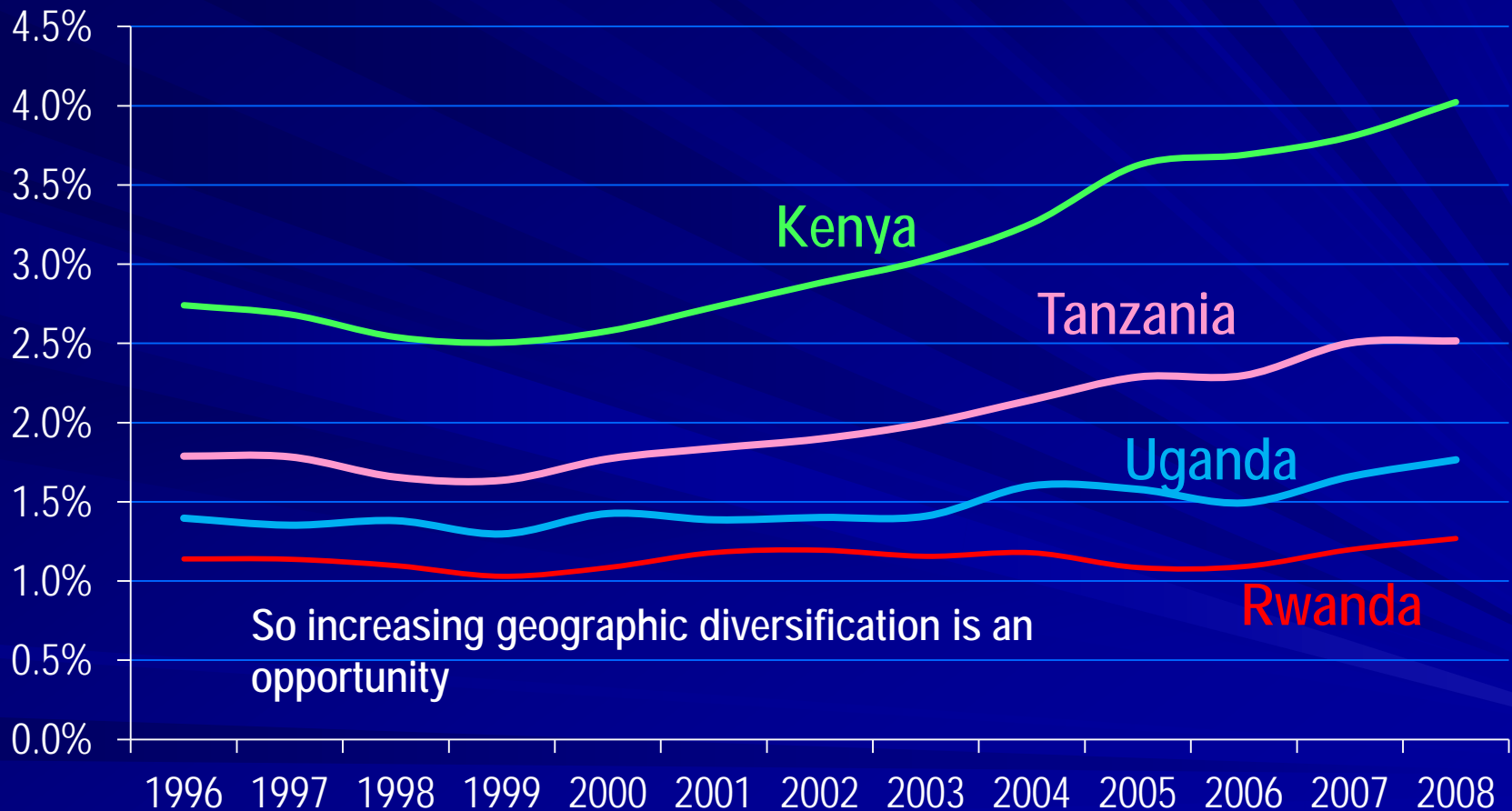
Average 2005-2009 index of export concentration



Source: Staff calculation based on SITC rev3 from Comtrade database

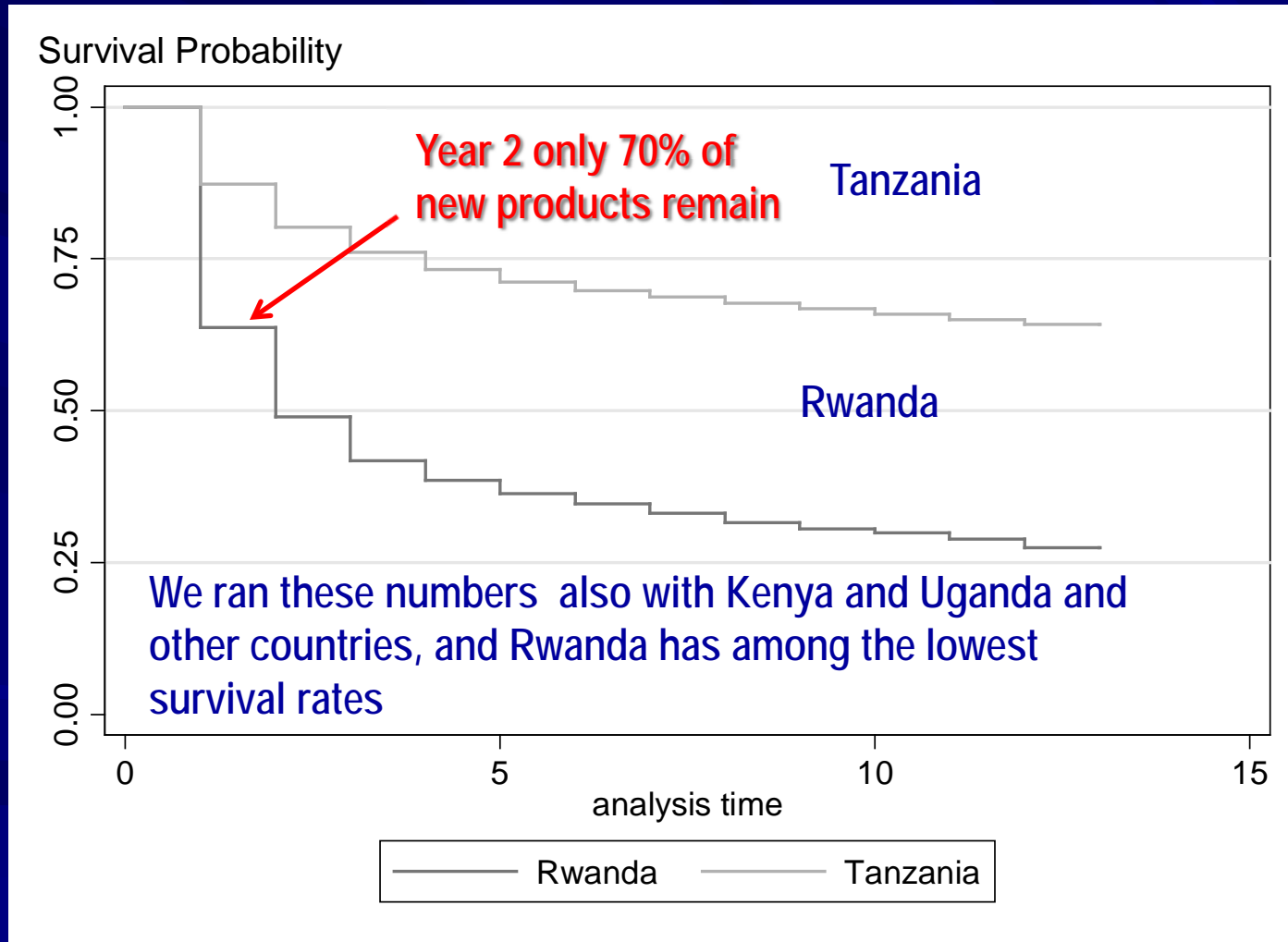
## ...and a relatively few geographic markets

Percent of countries importing the products that the EAC makes for the global market



Source: Staff calculations and WITS comtrade database

# Exports seem to “die young” ...the probability that a Rwandan export product will survive into future years is lower than most other countries



Scope for export promotion efforts to sustain products?

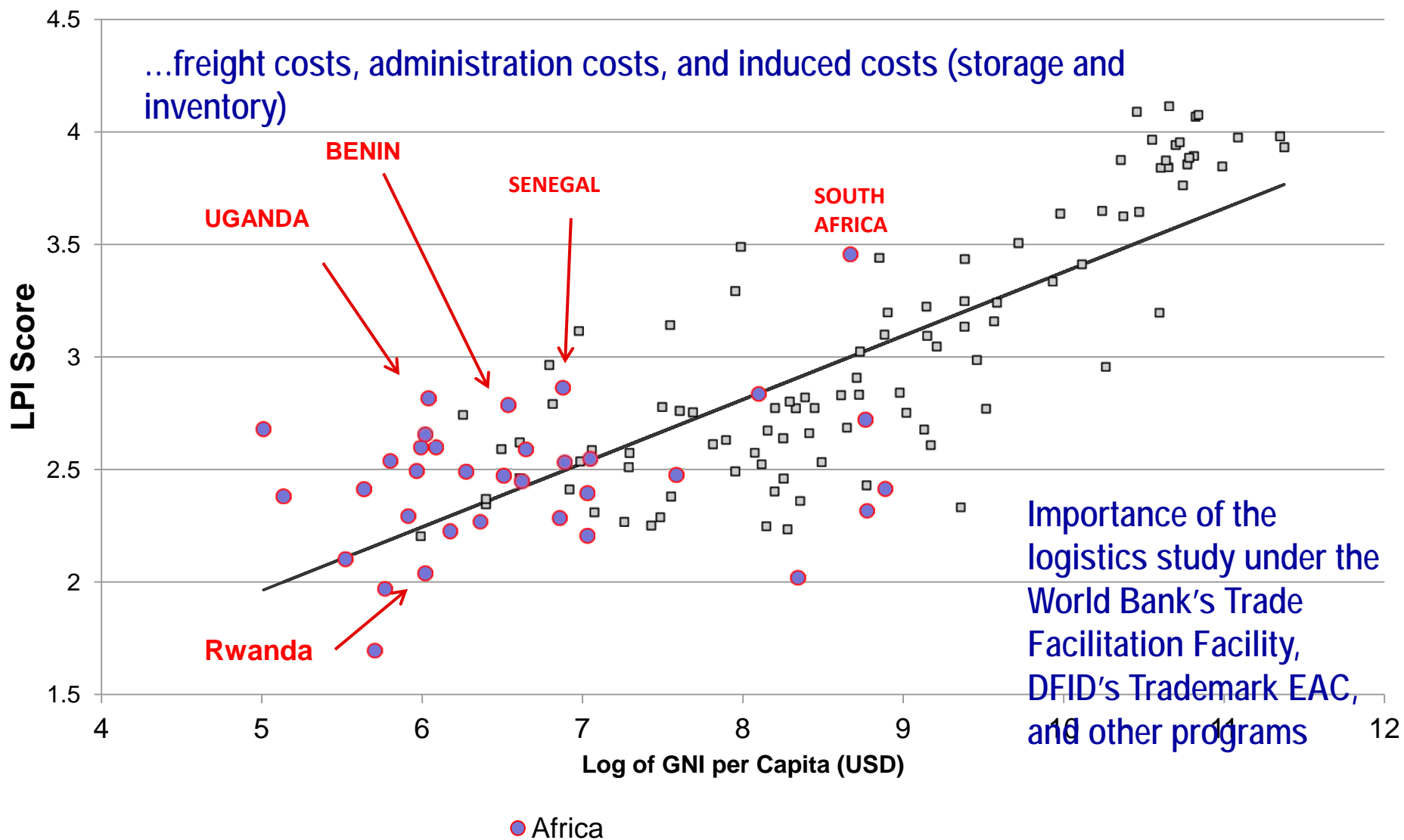


## From international experience, four determinants of success in trade beyond good investment climate...

- **Infrastructure** is a major constraint in most countries
- **Lowering costs of trading** is essential to rapid growth
- Regional trade agreements have to be designed to promote **deep integration**... otherwise smallest members suffer
- Managing the **real exchange rate** effectively is essential to maintain competitiveness

In each area, these lessons prompt questions that Rwandan authorities might want to address...

# Trading costs: Is there more Rwanda could do to lower its costs of logistics?



Regional integration agreements can be beneficial if they encourage deep integration. Could Rwanda do more to accelerate the creation of a single EAC market...?

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

# Non Tariff Barriers in the EAC have been reduced...but still drive up costs...

## Modest Progress to Date

- National Monitoring Committees established (not very effective)
- Some progress on reducing the # of road blocks
- But most of 35 NTBs that have been identified and agreed for immediate removal in December 2008 remain in place
- Need for more ambitious mutual recognition agreements in several fields – built around appropriate standards

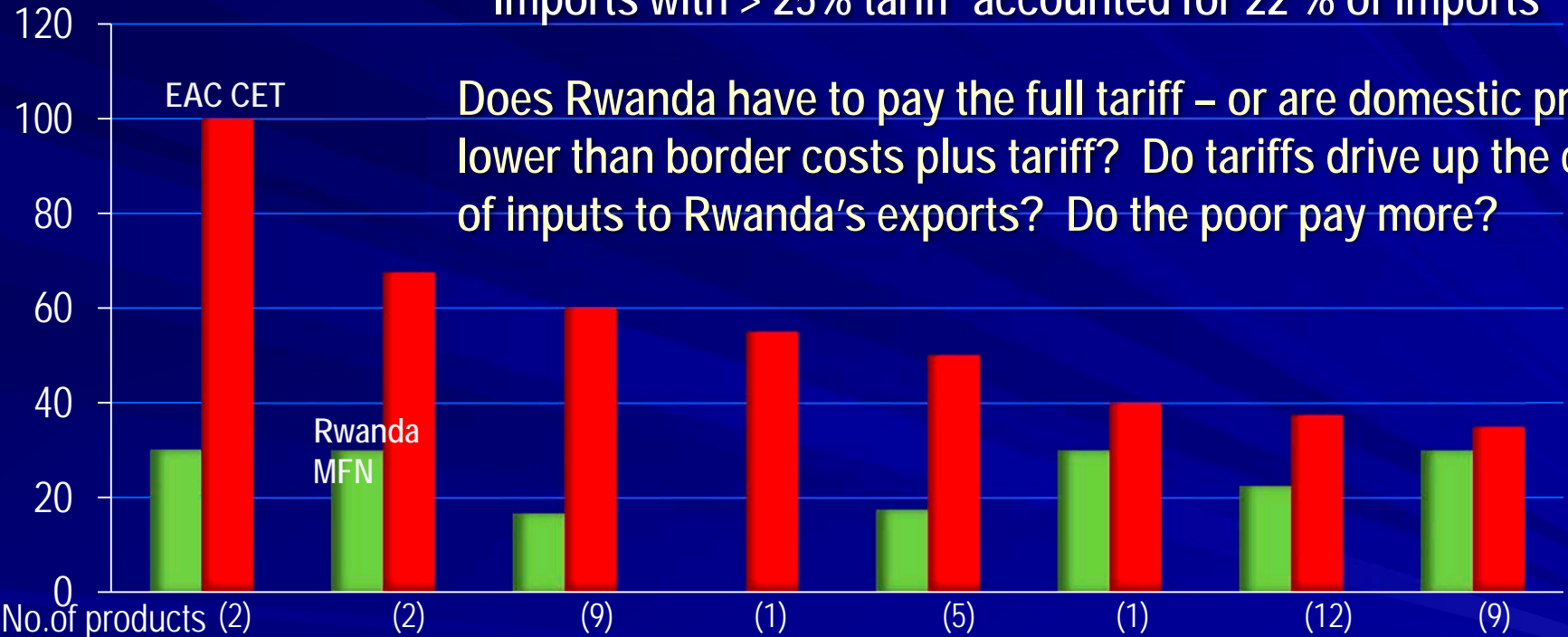
Scope for annual audit of progress, with private involvement?

# Tariffs: Are current levels of tariffs conducive to expanding exports? One issue: tariffs on sensitive products

Tariff rate

Imports with > 25% tariff accounted for 22 % of imports

Does Rwanda have to pay the full tariff – or are domestic prices lower than border costs plus tariff? Do tariffs drive up the cost of inputs to Rwanda's exports? Do the poor pay more?



Simple illustration:

$$\begin{aligned}
 P_x &= 100 \text{ (exports)} - 20 \text{ (transport)} &= 80 \text{ in earnings} \\
 P_m &= 100 \text{ (imports)} + 20 \text{ (transport)} + 30 \text{ (tariffs)} &= 150 \text{ in payments}
 \end{aligned}
 \left. \vphantom{\begin{aligned} P_x \\ P_m \end{aligned}} \right\} .53$$

$$\begin{aligned}
 P_x &= 100 \text{ (exports)} - 10 \text{ (transport)} &= 90 \text{ in earnings} \\
 P_m &= 100 \text{ (imports)} + 10 \text{ (transport)} + 0 \text{ (tariffs)} &= 110 \text{ in payments}
 \end{aligned}
 \left. \vphantom{\begin{aligned} P_x \\ P_m \end{aligned}} \right\} .82$$

Source: Carrere, De Melo (2007)

# Services are a fast growing segment of the global market and Rwanda is taking advantage

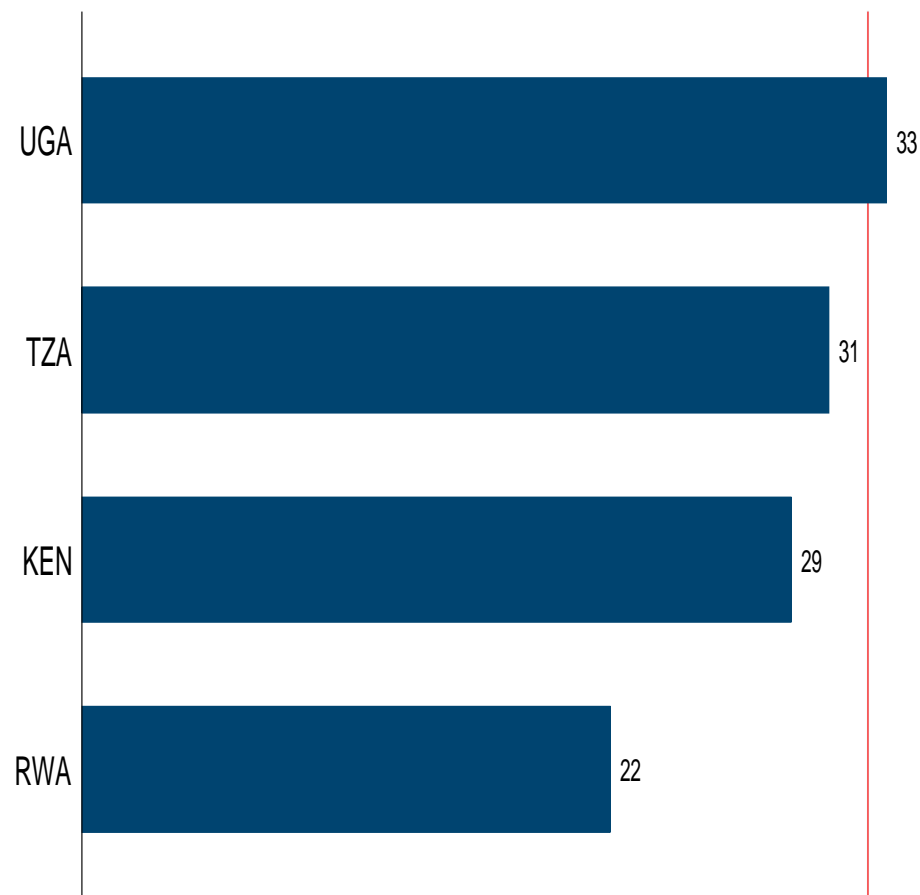
## Services exports from Rwanda

- Are larger than goods exports
- Grew at 25% vs 10% for goods (1998-2007)
- And have the second highest revealed comparative advantage of 23 African countries surveyed (RCA=2.75)

Rwanda is now more open than EAC on average - and in finance, retail, accountancy and legal services, but more restrictive in telecoms and transport

Recent liberalization has spurred FDI in Rwanda service

World Bank Services Trade Restrictiveness Index



**Are there ways Rwanda can leverage its openness to expand services exports?**

# Creating an open services markets in 2015: An EAC advisory group to advance integration?

- An EAC advisory group on services to promote “one market with competition”
- Evaluate policy options by bringing together **negotiators** with **regulators** and with **services experts** – focus of negotiators/regulators often is not on international trade/investment or on competition
- Assembling knowledge on regulation is sector-specific
  - A consultative mechanism to collect, analyze, and diffuse knowledge on services regulation and reform
  - A focal point for impact analysis – within EAC and for EPA negotiations
  - 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

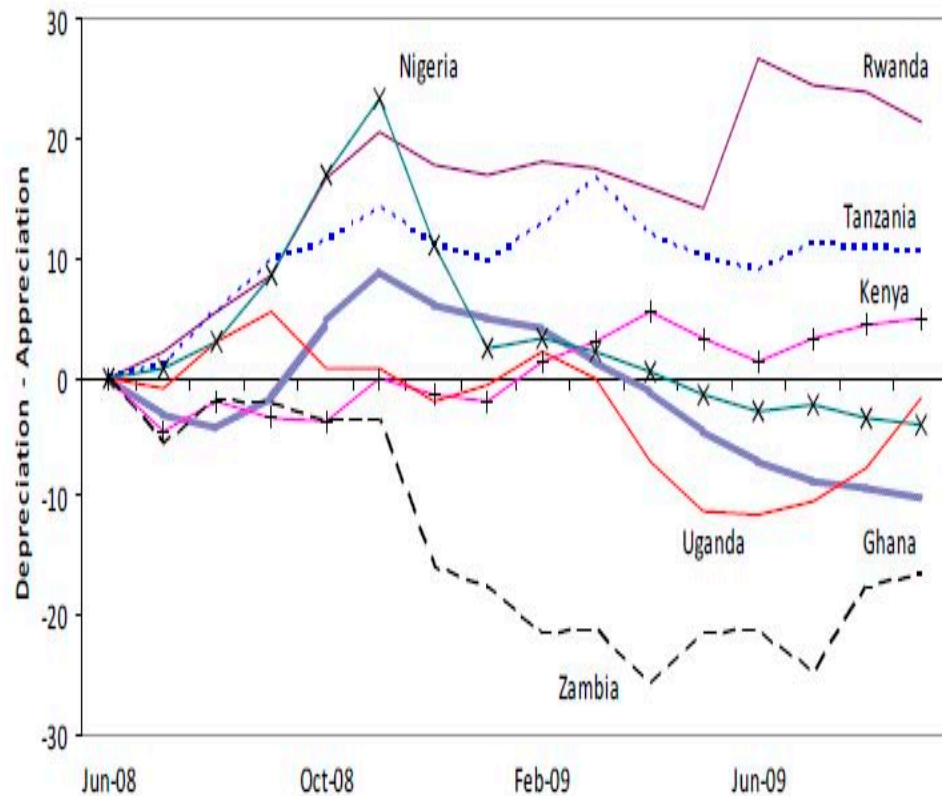
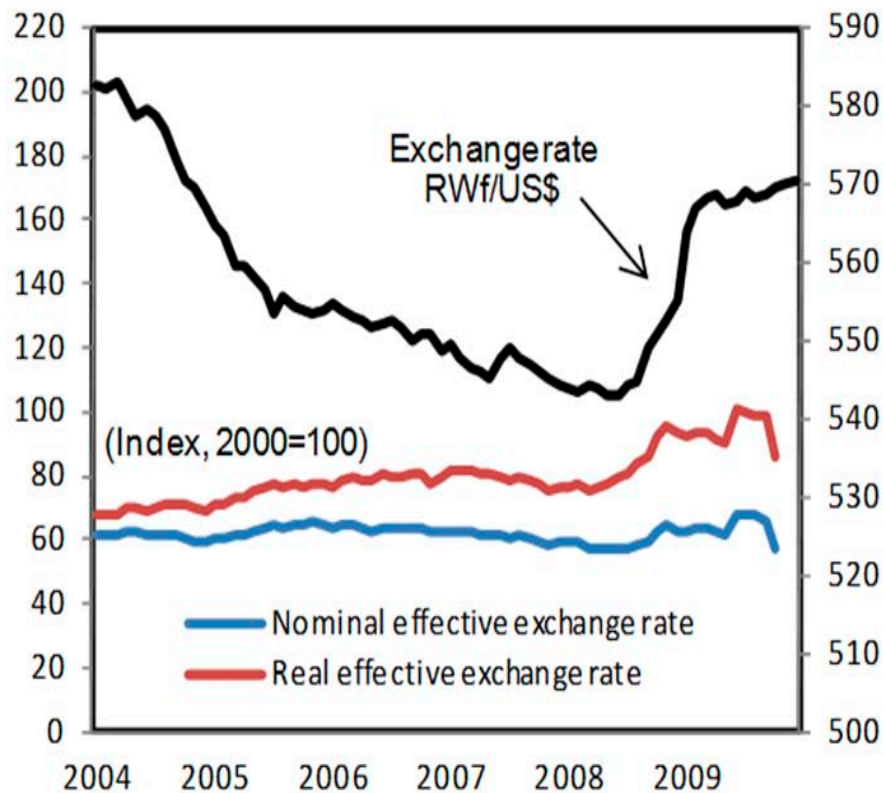
# Management of the real exchange rate: Important to facilitate export drives

- **Avoiding overvaluation** : Early success at exporting (or mobilizing donor finance) can drive up currency value – and raise price of exports.
  - **Aghion (2006)**: overvaluation leads to slow productivity growth
- **Maintain competitiveness**: Competitive exchange rate may foster growth learning by doing associated with productive activities for exports
  - **Hausmann, et al (2004)**: 80 “growth accelerations” of 2 % points – 8 years; real devaluation was significant predictor
  - **Country experiences**: Korea (1964-mid-1970s), Chile 1982-92, China post -1994
- **Conclusion**: Answer is not obvious, not easy and not cost-less: Appropriate policy mix depends on objectives and situation; REER targeting difficult; increasing reserves can be costly
- **Eichengreen, 2008**: “The real exchange rate is best thought of as a facilitating condition: keeping it at competitive levels and avoiding excessive volatility facilitates efforts to capitalize on these fundamentals...” (that is, education, savings, investment and institutional capacity to assimilate technology)



# ...is there room for a better alignment between monetary and trade –growth objectives?

Since the depreciation in the second half of 2008, the franc has been traded in a narrow range.



Source: IMF, Information Notice System.

...Rwanda may wish to undertake its own analysis

## Conclusions...

Rwanda's objective of using trade to power growth is well-formulated ...and the government has identified all the right issues... from infrastructure to trading costs to regional integration.

But active pursuit of policy issues on logistics management, on NTBs, tariff structure, greater services liberalization within the EAC, and management of the exchange rate – can help Rwanda realize its Vision 2020.

Specific ideas: Improve trade data; RDB review with private sector of “product deaths”; annual transport and trade facilitation audit with EAC and private involvement; create services EAC advisory group to promote creation of one services market.

**The International Growth Centre is ready to provide new research capacity to the government as it looks into any of these questions**

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