Chapter 2

Services Production and Trade in Kenya and Rwanda

This chapter discusses some of the salient features of services in the two countries under study. The focus is on sectoral characteristics over time, as well as trade relations. The chapter compares services trade integration to the case of goods, and looks in detail at intra- and extra-Commonwealth trade flows.

Box 2.1 Country strategy documents

This chapter draws on the following country strategy documents from Kenya and Rwanda documents to look at the role services play in their development programmes.

EAC and World Bank (2016) *East African Common Market Scorecard 2016*. Washington, DC: World Bank.

Government of Kenya (2010) 'Vision 2030: First Medium Term Plan (2008–2012)'. www.imf.org/en/Publications/CR/Issues/2016/12/31/Kenya-Poverty-Reduction-Strategy-Paper-24065

Government of Rwanda (2013) 'Economic Development and Poverty Reduction Strategy'. www.imf.org/en/Publications/CR/Issues/2016/12/31/Rwanda-Poverty-Reduction-Strategy-Paper-41127

State Department of Trade of Kenya (2017) 'Kenya – National Trade Policy'. www.trade.go.ke/sites/default/files/Kenya%20National%20Trade%20Policy%20%282016%29_0.pdf

UNCTAD (2014) *Services Policy Review: Rwanda*. Geneva: UNCTAD.

Kenya's Vision 2030, which seeks to transform Kenya into a newly industrialising, middle-income country providing a high quality of life to all its citizens by 2030, recognises selected services sectors, specifically tourism, business process outsourcing (BPO), information technology (IT), financial services and education and training, as being among the key services that will drive the economic development of the country. Likewise, Kenya's National Trade Policy (2017) recognises the importance of trade in services and commits to facilitating improvements in the enabling environment for increased trade in services in selected sectors.

Both Vision 2030 and the National Trade Policy place particular emphasis on the distribution sector, which accounts for 15.7 per cent of GDP, 10 per cent of formal employment and 58.7 per cent of informal employment. The Policy

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Box 2.1 (*Continued*)

notes that the sector lacks a clear legal and regulatory framework, which has impeded its growth. Additionally, it is burdened by cumbersome licensing requirements. The Policy therefore commits to 'providing an enabling legal and regulatory environment to support the growth and development of the distribution and wholesale sub-sector as well as a strong backward and forward linkage between the subsector and productive sectors of the economy'.

Under Vision 2030, the government's aim is to 'achieve a well-functioning financial system in order to accelerate economic growth by encouraging Foreign Direct Investment, safeguarding the economy from external shocks, and establishing Kenya as a leading financial center in Eastern and Southern Africa'. Financial service providers are diverse, including 42 commercial banks, 49 insurance companies, 12 deposit taking microfinance banks and 199 registered savings and credit cooperatives. Among the key targets under Vision 2030 is facilitating the transformation of the banking sector.

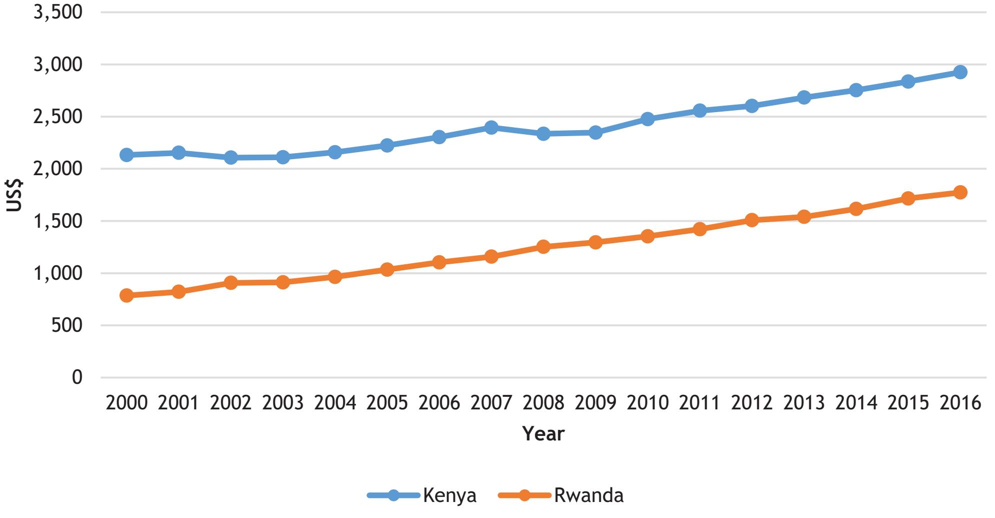
Rwanda's Economic Development and Poverty Reduction Strategy II (2013–2018) targets are heavily dependent on growth in exports from the services sector. The Revised National Export Strategy II has also prioritised exports of services and has developed export strategies for tourism services, information and communication technology (ICT) and BPO services, transport and logistics, distribution services, health and medical services, education services and financial services. Rwanda is among the least developed countries (LDCs) that are supposed to benefit from the WTO LDC Services Waiver as envisaged by Article IV of the GATS but to date has not made use of it. Priority export services sectors in Rwanda that may benefit from this waiver include ICT services (BPO), tourism (tours and travel operations), professional services (accounting services) and cultural services. While Rwanda has clearly done well in articulating sector-specific strategies for the development of the services sector, there is still a need for a holistic national services policy or trade in services strategy to boost services exports. Such a policy or strategy would identify overall services sector goals and measures to complement the existing sector strategies to ensure the overall development of services exports (UNCTAD, 2014).

2.1 Recent trajectory of the services sector

The services sector tends to grow in line with per capita income. But this does not mean countries in the low- and lower-middle-income groups, like Rwanda and Kenya, do not have important services sectors, or that services matter only for the economies of industrialised countries. This section reviews the recent evidence on the development of services in the two countries, focusing on production and aggregate trade, before the next section breaks the picture down into more detailed relationships.

Both Kenya and Rwanda have experienced rapid economic growth in the 2000s, which has translated into higher per capita incomes (Figure 2.1). Income growth in

Figure 2.1 GDP per capita in Kenya and Rwanda, 2000–2016 (constant 2011 PPP US$)



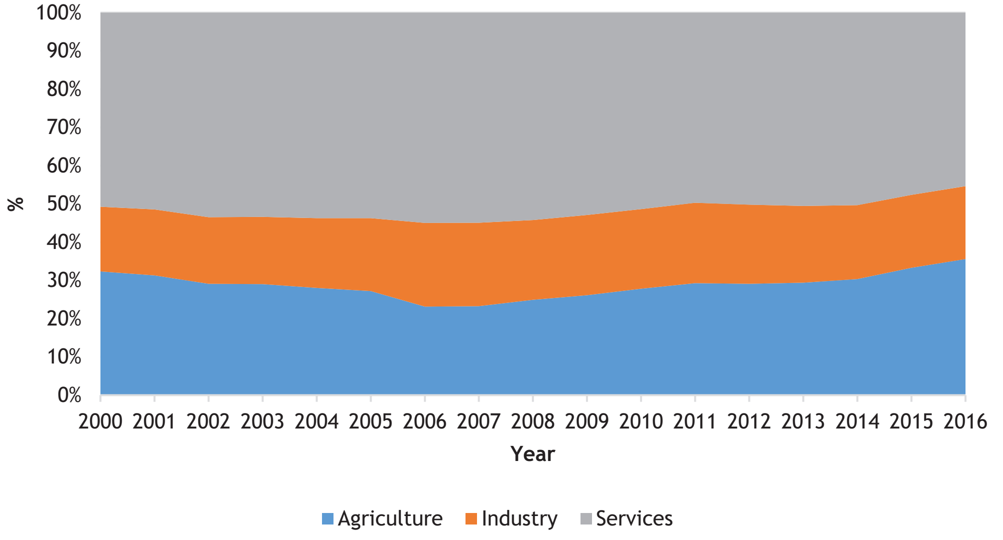
Source: World Development Indicators.

turn is one factor promoting growth of the services sector. Another is technological change, such as the introduction and wide dissemination of mobile phones, which has enabled the widespread use of mobile solutions such as payments systems, thereby increasing demand for and access to other types of services. For example, Argent et al. (2013) describe East African countries as 'the most successful users of mobile money' (p. 4). They report that, in a survey of 52 out of 129 mobile money operators, over 80 per cent of all transactions worldwide occurred in East Africa, with Kenya alone accounting for 34 per cent of transactions and 20 per cent of users.

Kenya is the largest services economy in the East African Community (EAC). The country's services sector amounted to 45 per cent of GDP in 2016 (World Development Indicators). From a development perspective, it is usual to see a larger proportion of industry and services in GDP as the population transitions out of agriculture and into higher value added activities. This pattern is evident in Kenya from 2000 through 2007 but changes in 2008: agriculture as a share of the economy is growing relative to the other two macro sectors, largely at the expense of services (Figure 2.2). In 2008, agriculture contributed just under 25 per cent of GDP, industry 21 per cent and services 54 per cent; by 2016, the figures were 36 per cent for agriculture, 19 per cent for industry and 45 per cent for services, clearly demonstrating the dynamic referred to in the previous sentence.

Although Kenya's services sector accounts for a large share of total economic activity, international trade is relatively limited.[1] This result is in line with the findings of Miroudot et al. (2012), who show that trade costs tend to be high in services sectors, particularly in lower-income countries, which in turn can constrain trade. As a result, Kenya's share in world services imports and exports came to only 0.06 per cent and 0.07 per cent, respectively, in 2016 (WTO, 2017). Total trade in services—that

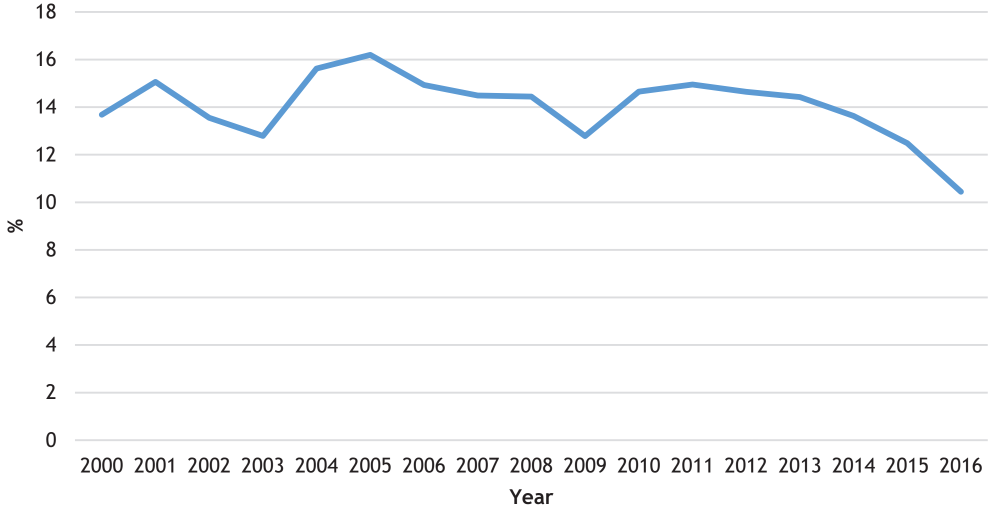
Figure 2.2 Breakdown of Kenya's GDP by macro sector, 2000–2016 (%)



Source: World Development Indicators.

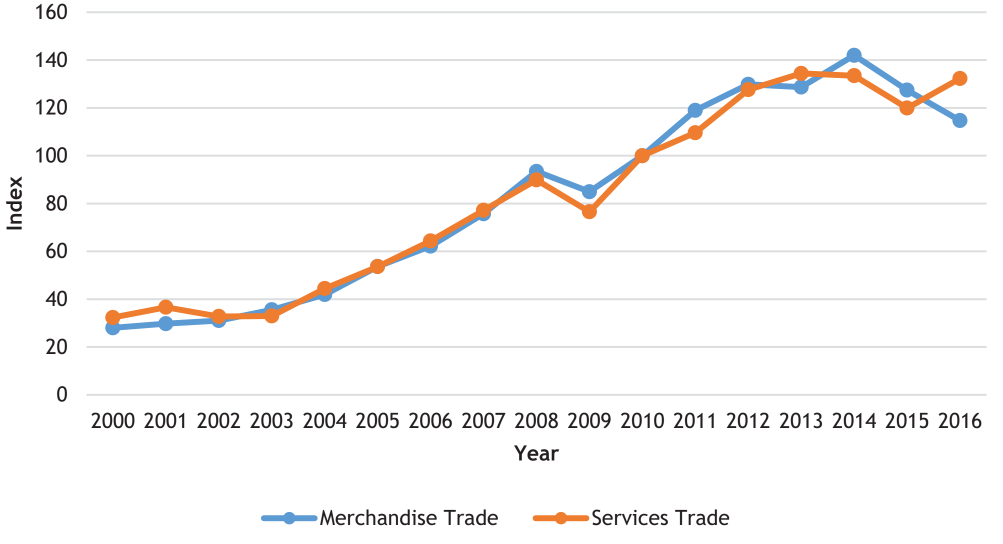
is, aggregating across all sectors, relative to GDP—decreased from 13.7 per cent in 2000 to 10.4 per cent in 2016, the latest year for which data are available (Figure 2.3). These overall data do not distinguish growth patterns among different sectors, a point returned to below. Kenya's National Trade Policy aims to 'promote expansion of trade in services targeting the regional and global market through measures that ensure Kenya remains competitive in the trade in services arena in the global market' (State Department of Trade of Kenya, 2017). The services sector has also been identified

Figure 2.3 Services trade relative to GDP, Kenya, 2000–2016 (%)



Source: World Development Indicators.

Figure 2.4 Kenya's trade in goods and services, 2000–2016, index (2010=100)



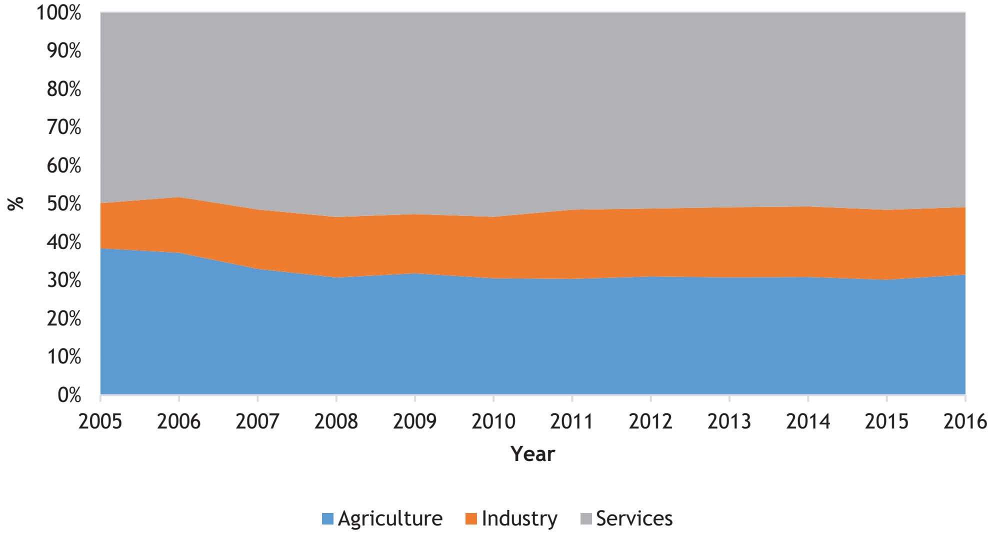
Source: World Development Indicators.

under the National Export Strategy (which is currently under discussion) as one of the key sectors targeted for export-led growth.

Although the above figure indicates that services trade has been growing slower than GDP in Kenya in recent years, it is important to nuance this perspective by comparing it with goods trade performance. Figure 2.4 does just that, by rebasing goods and services trade to be 100 in 2010, to make it possible to interpret changes in percentage terms. Over the past decade and a half, goods and services trade in Kenya have grown in tandem, with 2016 showing significantly faster growth in services than in goods. The conclusion is that integration of services markets in Kenya has been proceeding in much the same way as for goods, with significant growth in trade over recent years, particularly since the early 2000s.

Unlike Kenya, where the services sector has been contracting relative to other activities in recent years, the share of the sector in total value added in Rwanda has remained essentially constant, at around 50 per cent (Figure 2.5). Rwanda aspires to become a knowledge-based, services-led economy by 2020 through the diversification of services, enhancing skill levels, investment in technology and trading of services across the Eastern African region and beyond. The share of agriculture declined sharply between 2005 and 2008 in favour of industry. There is evidence of substantial structural change having taken place in Rwanda, but the pace seems to have slowed in recent years based on these aggregate data. From 2005 to 2010, the share of industry in GDP increased from 12 per cent to 16 per cent, and that of services from 50 per cent to 53 per cent. However, from 2010 to 2016, the share of industry grew by only 2 more percentage points, to 18 per cent, while the share of services fell slightly, to 51 per cent.

Figure 2.5 Breakdown of Rwanda's GDP by macro sector, 2005–2016 (%)

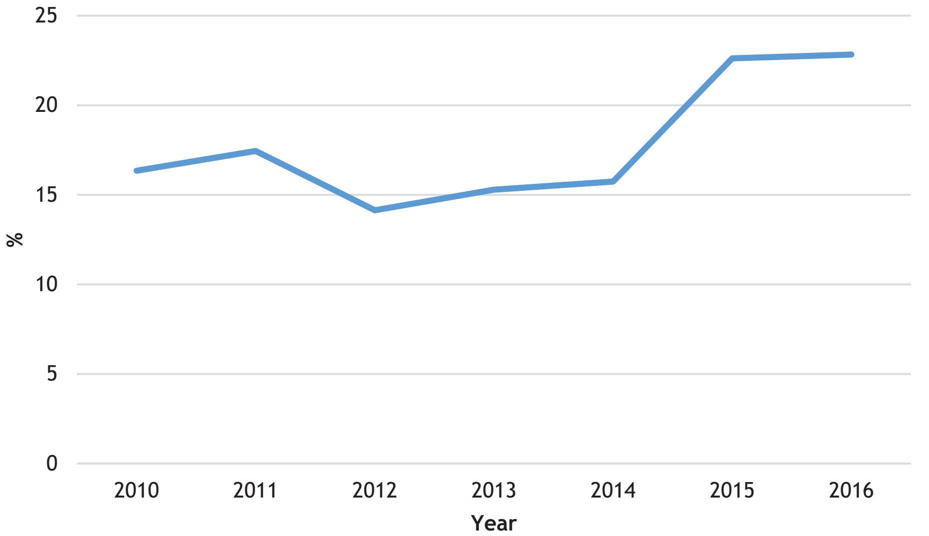


Source: World Development Indicators. Note: Data not available prior to 2005.

Rwanda's shares in world imports and exports in 2016 were 0.02 per cent and 0.01 per cent, respectively (WTO, 2017). Although Rwanda's trade share is more modest than Kenya's—in keeping with its smaller size—services account for a significant share of total economic activity.

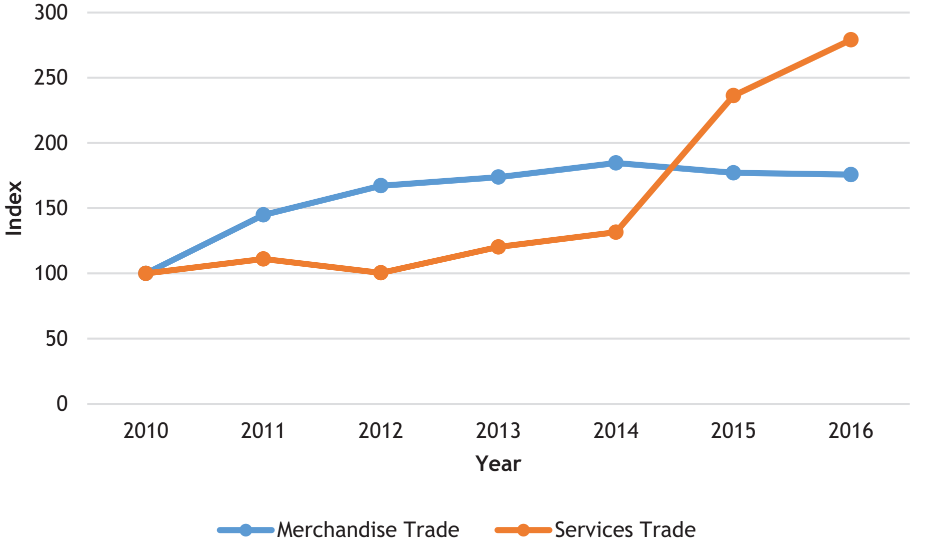
Likely because of high trade costs in services sectors, services trade relative to GDP (Figure 2.6) is smaller than would the sector's proportion in total value added would

Figure 2.6 Services trade relative to GDP, Rwanda, 2010–2016 (%)



Source: World Development Indicators. Note: Data not available prior to 2010.

Figure 2.7 Rwanda's trade in goods and services, 2000–2016, index (2010=100)



Source: World Development Indicators and authors' calculations. Note: Data not available prior to 2010.

suggest. Nonetheless, services trade relative to GDP has been increasing over recent years, which is evidence of increasing integration between Rwanda and the global services economy. The issue of sectoral composition is important, and this is returned to below.

Figure 2.7 compares Rwanda's growth in trade integration in goods and services. Although the growth rate of services trade was initially lower compared with goods, the position has inverted over the past few years, so that services trade is now growing considerably more rapidly than goods trade. Rwanda has been leveraging trade integration to help promote its development objectives, and Figure 2.7 suggests the strategy has moved beyond goods to also include services.

2.2 Commonwealth and non-Commonwealth partnerships in services trade

This section provides further details on Kenya's and Rwanda's services trade in terms of value, evolution and main trade partners. It is worth mentioning that the data on services trade are captured from the Balance of Payments (BoP) statistics. Because these statistics record cross-border transactions of an economy with other countries, they can reflect trade in services only in some modes of supply. Mainly, they record services trade under cross-border supply (Mode 1) and consumption abroad (Mode 2) for some services, such as travel services. Therefore, BoP statistics do not allow for comprehensive measurement of services supplied under Mode 3 or Mode 4.

Box 2.2 Trading services internationally under the GATS

Under the WTO GATS, trade in services is defined as *supply of services* in four modes of supply. Mode 1 is cross-border supply from the territory of one country into the territory of another country. Mode 2 is consumption abroad—that is, the service is supplied in the territory of one country to the consumer of another country. Mode 3 is commercial presence: the service is supplied by a service supplier of one country through commercial presence in the territory of another country. Finally, Mode 4 is the supply of a service through the presence of service suppliers from one country in the territory of another country. Service suppliers may act as independent suppliers or service supplier's employees.

Some services can be provided in all four modes of supply depending on particular circumstances. For example, legal services may be supplied to clients in all four modes:

Mode 1: Legal advice is given to a client based abroad via electronic means.

Mode 2: A client coming from abroad receives legal advice in a lawyer's office.

Mode 3: A law firm establishes a legal entity or branch office abroad to provide legal services.

Mode 4: A lawyer goes abroad to provide legal advice to a client based there.

On the other hand, some services cannot be supplied in some modes of supply, owing to lack of technical feasibility. For example, the services of maintenance and repair of transport equipment cannot be supplied in Mode 1 (cross-border supply) because they would most probably require physical presence of a service supplier near the equipment through Modes 2, 3 or 4.

Another aspect of trade in services is 'servicification'. Servicification refers to the trend whereby manufacturers of goods are increasingly relying on services either as inputs (software installed in a technological product), activities within firms (in-house services that would belong to services industries had they been outsourced) or outputs sold in connection with goods (some manufacturers also provide distribution, transport or maintenance and repair services for equipment) (see National Board of Trade of Sweden, 2016 and Miroudot, 2017). This kind of trade does not constitute a separate mode of supply but is frequently referred to as embodied services trade, in the sense that services are traded indirectly by being embodied in goods that move across borders.

Although availability of trade data on the different modes of supply is very limited, it is possible to construct STRIs that cover all modes. That is because STRIs are based on regulatory data, not trade data. This project therefore covers all modes of supply in its regulatory analysis, even though the review of trade data is more circumspect in this section owing to severe availability issues.

An additional limitation is that neither Kenya nor Rwanda maintains fully disaggregated data on trade in services in their BoP statistics. What this means is that they record exports and imports with an aggregate partner (the world), not individual countries. These data on total services trade are available through multiple sources, but this study uses the World Development Indicators for its most aggregate analysis. An additional problem is that sectoral disaggregation, even with the world as trading partner, is limited. While aggregate data can be useful for some purposes, such as in tracking broad trends over time, they leave a significant gap in understanding in terms of the composition and destination of a country's exports, and the composition and sources of its imports. To try and fill this gap, this study uses the OECD–WTO Balanced Trade in Services (BaTiS) database, which was recently released on an experimental basis. This uses mirroring techniques and modelling to fill in missing observations either by sector or by partner in the bilateral services trade matrix. These data are used in full knowledge that, for Kenya and Rwanda, they are largely constructed using econometric models, not via direct observation. This imposes severe limitations on how strictly they can be interpreted, but they nonetheless shed some light on questions that have to date remained completely obscured.

Box 2.3 Trade data resources for Commonwealth countries

Trade data availability is a serious constraint for empirical work on services. The problem is acute in Commonwealth countries, particularly for low-income countries and small economies. For example, as of 2014, 40 Commonwealth countries reported some export data from their BoP statistics to UN Comtrade, the central international repository for trade data. However, only six—Australia, Canada, Cyprus, Malta, Singapore and the UK—break down total exports into subtotals by trading partner. This kind of bilateral disaggregation is a crucial building block for nearly all empirical work on international trade. The absence of bilateral trade data for the vast majority of Commonwealth countries means it is very difficult to conduct research that includes them and that takes account of their special characteristics.

A number of options are available to empirical researchers to try and loosen this constraint. First, they can apply mirroring: for instance, if Rwanda's bilateral export data are unavailable, it is possible to approximate them using reported imports from trading partners. This solution is partial, essentially capturing most North–South trade but very little South–South or intra-regional trade. In addition, as of the end of 2017, the OECD and the WTO have made available an experimental dataset (BaTiS) that applies mirroring but also uses econometric models to estimate missing data. This dataset gives the most complete picture currently available of services trade globally, but it is important to stress that, for countries like Kenya and Rwanda, much of the data is modelled rather than directly observed.

(*Continued*)

Box 2.3 (*Continued*)

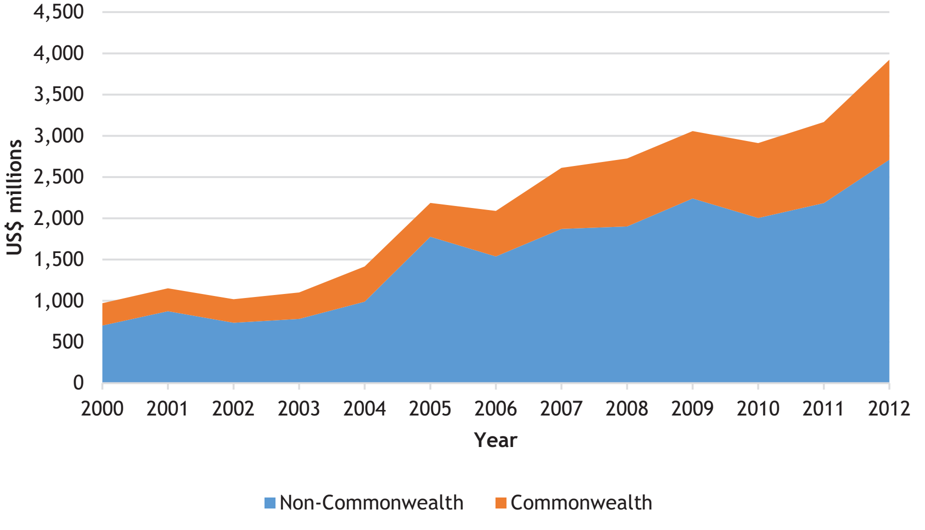
Although data availability is limited for the BoP, which captures trade essentially in GATS Modes 1 and 2, the problem is much worse for the other modes of supply. Mode 3 data are generally maintained only by major economies that are members of the OECD. Mode 4 data are not systematically recorded anywhere. An effort is underway, led by WTO, to produce estimates of services trade by mode of supply for a large number of countries applying a simplified statistical approach, but the dataset is not yet available.

Kenya's services trade has been growing strongly over recent years. Thus, services imports almost tripled in the decade through 2012, the latest year for which disaggregated data are available in the OECD–WTO BaTiS database. Figure 2.8 exploits the disaggregation of trade flows by country to show the development of imports from Commonwealth partners and those from the rest of the world. Over the time period considered, intra-Commonwealth imports grew by 346 per cent, whereas those from the rest of the world increased by 288 per cent.

Kenya's services exports increased strongly through 2012 (Figure 2.9). Exports to other Commonwealth countries increased by 275 per cent, whereas exports to the rest of the world increased by 261 per cent.

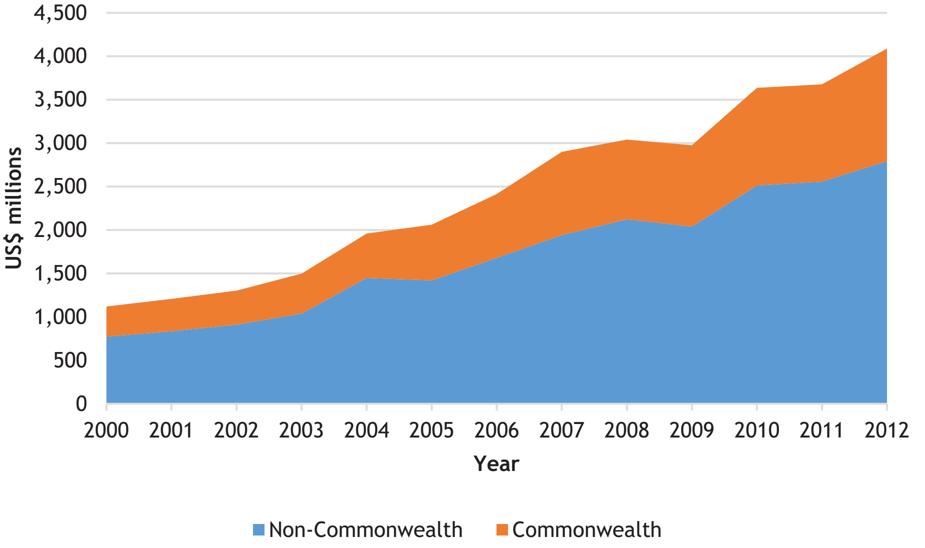
As the observed differences in growth rates between trade with Commonwealth partners and trade with the rest of the world suggest, the Commonwealth as a group represents an increasingly important share of Kenya's total services trade. In 2012, Commonwealth countries supplied 30.9 per cent of Kenya's services imports, and accounted for 31.7 per cent of its exports. Leading Commonwealth partners include

Figure 2.8 Kenya's services imports, 2000–2012 (US$ millions)



Source: WTO–OECD BaTiS dataset; authors' calculations.

Figure 2.9 Kenya's services exports, 2000–2012 (US$ millions)

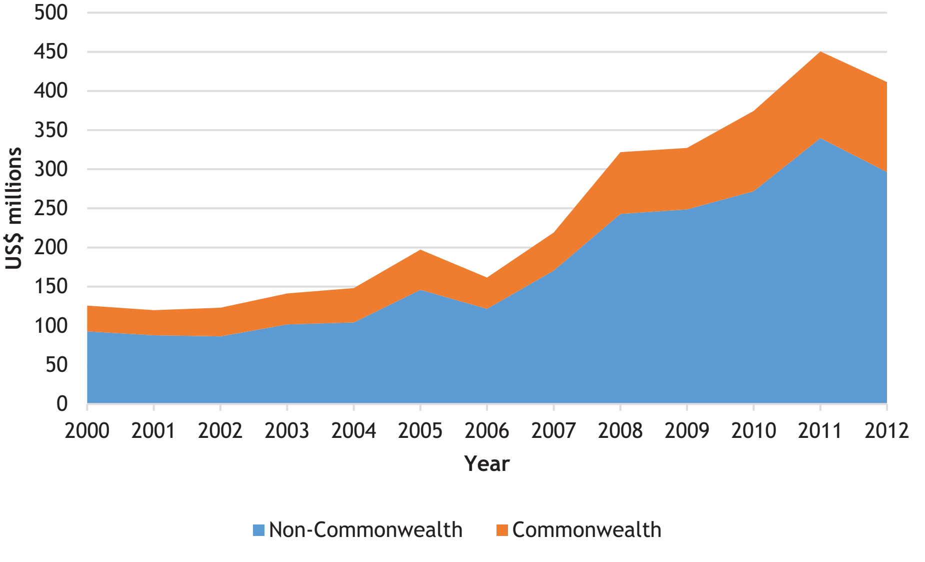


Source: WTO–OECD BaTiS dataset; authors' calculations.

the UK and India on both the import and export sides, whereas the largest trading partners outside the Commonwealth include the USA and the EU (Germany, France and the Netherlands).

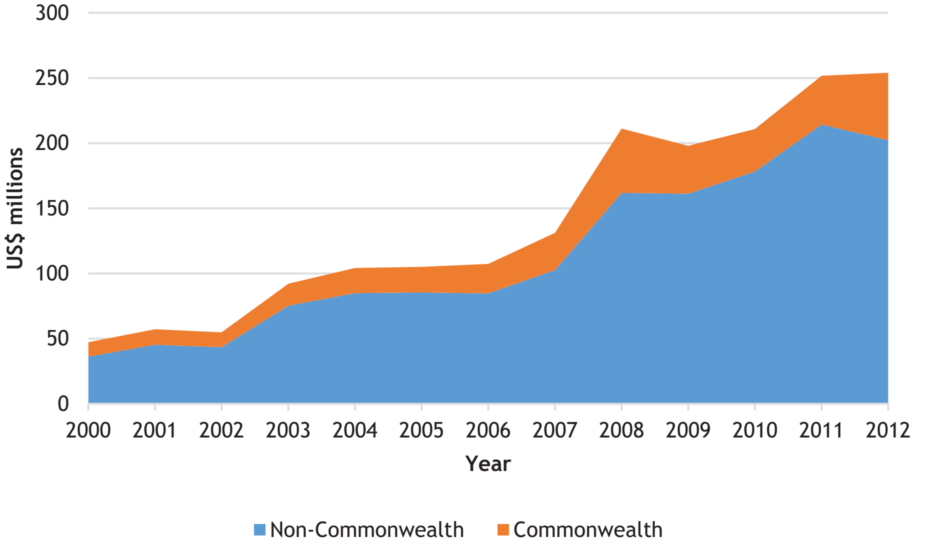
As in Kenya's case, Rwanda's services imports have been increasing in absolute terms (Figure 2.10). The breakdown into Commonwealth and other sources shows that

Figure 2.10 Rwanda's services imports, 2000–2012 (US$ millions)



Source: WTO–OECD BaTiS dataset; authors' calculations.

Figure 2.11 Rwanda's services exports, 2000–2012 (US$ millions)



Source: WTO-OECD BaTiS dataset; authors' calculations.

imports from the former increased by 350 per cent through 2012, whereas for the latter the comparable figure was 319 per cent.

Rwanda's services exports also increased sharply through 2012 (Figure 2.11). Exports to other Commonwealth countries grew by 366 per cent, whereas those to the rest of the world grew by 459 per cent.

In terms of shares of imports and exports, Commonwealth countries represent important sources of imports and destinations of exports for Rwanda, as was the case for Kenya. In 2012, intra-Commonwealth imports accounted for 27.9 per cent of the total, while the corresponding figure for exports was 20.4 per cent. Key Commonwealth trading partners include India, the UK, Kenya and Uganda. Among non-Commonwealth countries, Rwanda has important services trade links with the USA, China and the EU (Germany, the Netherlands, Sweden and Belgium), as well as Switzerland.

This review of the data has shown that Kenya and Rwanda are both active in services trade, and are becoming increasingly so over time as their services sectors grow and become more competitive. The Commonwealth is an important part of an overall pattern of increasing trade integration: for all directions of trade except Rwanda's exports, integration with Commonwealth countries has been growing more quickly than with the rest of the world. The analysis here is necessarily partial, and limited to the BoP statistics. It relies extensively on synthetic data generated by econometric models, as well as data generated by trading partners. Although this exercise is informative, it is an urgent policy priority for Kenya and Rwanda, and indeed for most other Commonwealth countries, to develop the statistical capacity to track trade in services more comprehensively.

2.3 Services and market integration: The regional dimension

Kenya and Rwanda are both members of the EAC. In 2010, the EAC instituted the first common market arrangement in Africa. This is based on the free movement of economic output and agents, including services. Instituting a full common market in services is a very ambitious agenda item, but it highlights the commitment of EAC countries to increasing regional integration, with the aim of promoting economies of scale and developing the competitiveness needed to succeed in world markets. However, it is important to keep in mind that facilitating trade in services is an ongoing commitment, not the putting in place of a one-off set of reforms like instituting a customs union for goods. Indeed, the EU has been working to promote continued reforms to its own single market for services, navigating a complex interplay of domestic political interests and regulatory complexity.

As a measure of transparency and to facilitate peer review and promote progress, the EAC has published two Common Market Scorecards, in 2014 and 2016. These cover services, and identify member country commitments under Annex V of the EAC Common Market Protocol, as well as recent reforms. EAC and World Bank (2016) show that EAC countries have been active in committing to integrating their services markets. The Common Market Protocol (CMP) identifies seven priority sectors: business; communication; distribution; education; financial; tourism and travel; and transport. Within these sectors, Rwanda has committed to open the most subsectors (103 out of a maximum of 136) of any EAC country. Kenya has made commitments in 63 subsectors (Table 2.1). Kenya has committed to liberalise an additional 22 subsectors, taking the total committed under the CMP to 85. This is in line with the EAC Council of Ministers directive that each Partner State commit a minimum of 78 subsectors. In addition, Kenya and Rwanda are both expected to commence negotiations to liberalise five additional subsectors: construction services; environmental services; health-related services; social services; and recreational, cultural and sporting services.

A key contribution of the Scorecard exercise lies in monitoring the extent of compliance with the common market's requirements in different sectors, and across countries as provided for by Article 50 of the EAC CMP. The publications track

Table 2.1 Services subsectors committed under the EAC CMP, Kenya and Rwanda

Liberalised services sectors	Rwanda	Kenya
1. Business services	32	15
2. Communication services	20	17
3. Distribution services	4	3
4. Educational services	5	4
5. Financial services	16	12
6. Tourism and travel-related services	4	3
7. Transport services	22	9
Total number of subsectors committed	103	63

Source: EAC and World Bank (2016).

non-conforming measures (NCMs), which can then be targeted for removal over time. Both Scorecards have focused on four sectors: professional services (legal, accounting, architecture, engineering); transportation services (air and road); telecommunication services; and distribution services (wholesale and retail trade). EAC and World Bank (2016) find that Rwanda had 10 NCMs in 2016, down from 11 in 2014. Kenya had 14, down from 16 in the previous report. Kenya's NCMs were concentrated in professional services and telecommunications, whereas Rwanda's were mainly in professional services and transport.

Monitoring regional integration of services markets is important for the development of the services sector in the EAC. However, it is a different exercise from the one this study intends to carry out. The objective here is to catalogue and quantify the policies Kenya and Rwanda maintain on an applied most-favoured nation (MFN) basis—that is, to those countries with which they do not have a preferential agreement covering services. This is in keeping with the STRI exercises that have been conducted previously by the Australian Productivity Commission, the World Bank and the OECD. Of course, it would possible to extend this work in the future to look at the different rates of restrictiveness of MFN and preferential policies, but first it is necessary to obtain a baseline that can be used for comparison. In terms of economic impact, it is important to note that imports from other EAC countries accounted for only 2.0 per cent of Kenya's total services imports in 2012, while the corresponding figure for Rwanda was 8.2 per cent. As a result, focusing on non-preferential policies ensures that the trade policy measures that affect the overwhelming bulk of imports in both countries are captured.

Note

1 See below for a discussion on the difficulties of measuring trade in services according to the GATS modes of supply in Kenya and Rwanda. The figures quoted in this section represent lower bounds on total services trade.

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