Chapter 4

Kenya and Rwanda STRIs: Overview of Results

This chapter summarises the STRIs produced by the OECD Secretariat using the raw data collected for this study. The indices are fully comparable with those calculated for the main OECD STRI project. The focus is on comparisons with other Commonwealth countries, but also record overall averages and compare performance with other developing countries for context. In all cases, STRIs range between 0 (no recorded restrictions) and 1 (closed market).

In the three sectors assessed (commercial banking, distribution services and road freight transport services), the findings suggest overall levels of restrictiveness lower than what is observed in major developing countries for which data are available: the scores of both countries are more liberal than those for India within the Commonwealth, and those for Indonesia (all sectors) and Brazil and China (two sectors) outside it. Kenya and Rwanda both have scores that are comparable with those of South Africa in commercial banking and distribution, although they are more restrictive in the case of road freight transport.

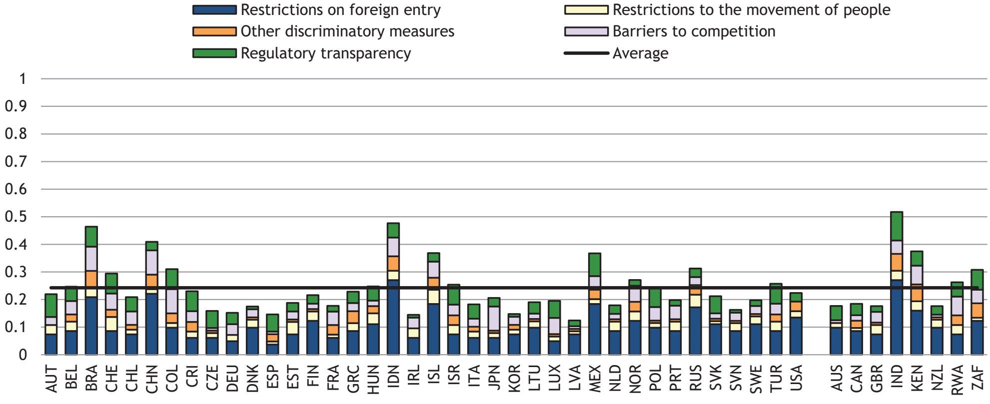
4.1 Commercial banking

Figure 4.1 shows STRIs for the commercial banking sector. Kenya, with a score of 0.37, and Rwanda, with 0.26, are both more restrictive than the average across all countries for which data are available (0.24), but the difference is only slight in the case of Rwanda. Moreover, OECD members dominate the average across all countries. Comparing Kenya and Rwanda with middle-income countries like Brazil (0.46), China (0.41), Indonesia (0.48), India (0.52) and South Africa (0.31) shows that they are generally more liberal or at least comparable in restrictiveness in this sector despite their lower level of per capita income. Indeed, neither Kenya nor Rwanda has restrictions that have historically been common in developing countries, such as restrictions on repatriating profits. The general picture that emerges for this sector is that Kenya and Rwanda are relatively liberal, in particular in comparison with other developing countries for which data are available.

Figure 4.2 zooms in on the Commonwealth countries in the sample, which are mostly developed. In comparison with their Commonwealth peers, Kenya and Rwanda, with scores of 0.37 and 0.26, respectively, are more restrictive than the developed Commonwealth countries: Australia has a score of 0.17, Canada 0.18, the UK 0.18 and New Zealand 0.18. However, both countries are less restrictive than India (0.52), and Rwanda is also less restrictive than South Africa (0.31).

To see where these results come from, individual groups of measures are reviewed separately. In terms of restrictions on foreign entry, Rwanda has the equal lowest score among Commonwealth countries (0.07), whereas Kenya has the second highest

Figure 4.1 STRIs in commercial banking, all countries, 2018 for Kenya and Rwanda, 2017 for others



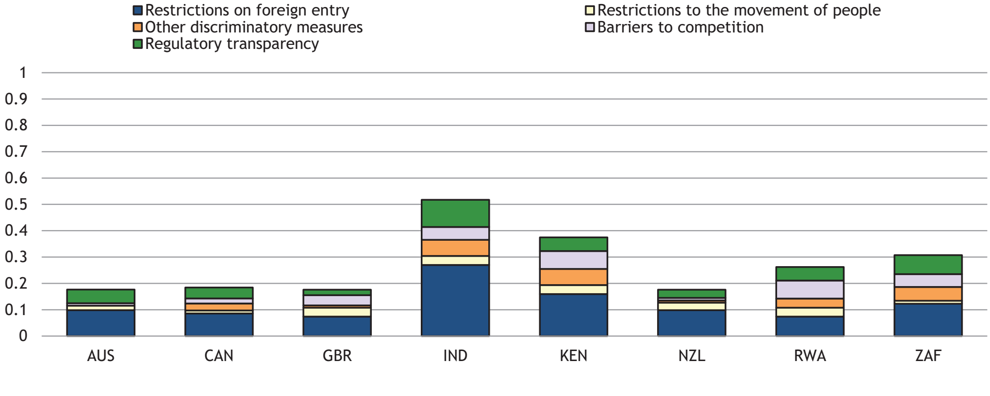
Source: OECD, based in part on data supplied by the authors.

(0.16) after India (0.27). The difference between Kenya and Rwanda is largely because foreign investments in Kenya—regardless of sector—have to be shown to benefit the country, and are subject to administrative discretion;[1] in Rwanda, by contrast, there is no such requirement. However, both countries restrict land ownership by foreigners, and require commercial presence for the provision of commercial banking services.

Both countries have high scores relative to comparators in the area of restrictions on people movements, being equal to India (0.03) and above all other Commonwealth countries in this case. These high scores stem from the use of labour market tests in both countries: for example, Kenya requires firms to show they were unable to fill a vacancy locally before using a foreign transferee or service supplier, and that programmes are in place to provide training to locals.

In terms of other discriminatory measures, Kenya's score is equal highest in the Commonwealth sample (with India: 0.06), whereas Rwanda's (0.03) is below those of

Figure 4.2 STRIs in commercial banking, Kenya and Rwanda plus Commonwealth comparators, 2018 for Kenya and Rwanda, 2017 for others



Source: OECD, based in part on data supplied by the authors.

India and South Africa (0.05) but above those of the other countries. The countries' scores essentially stem from restrictions on public procurement designed to favour local firms in both countries, and differential tax treatment in Kenya.

Kenya and Rwanda have the equal highest (0.07) scores in terms of barriers to competition in the commercial banking sector. In Kenya, banks are subject to regulated interest rates on loans and deposits, and there is public sector involvement in some commercial banks. Rwanda does not regulate rates, but has public sector involvement, and requires approval before banks can issue new products. By contrast, Australia and New Zealand both have very few restrictions on competition, with both countries scoring 0.01.

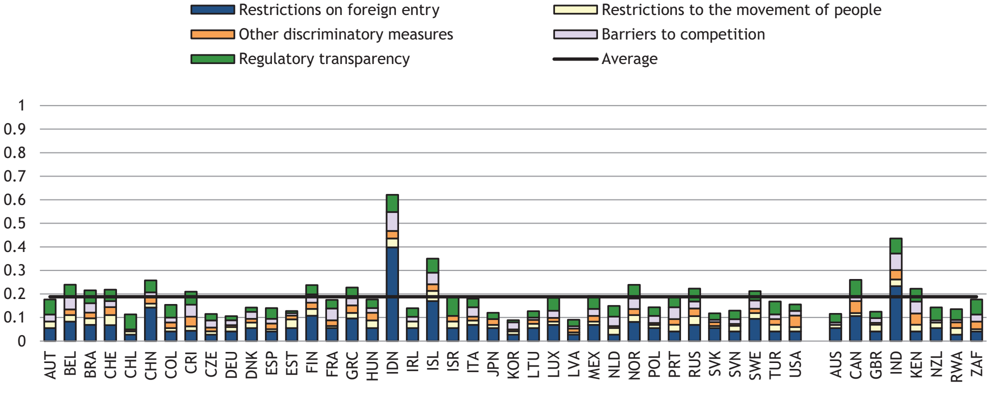
Finally, in terms of regulatory transparency, restrictive measures are relatively limited, on a par with what is observed in Australia (0.05); both countries have lower scores than India (0.10) and South Africa (0.07), which is consistent with a lower level of restrictiveness than those two countries.

Taking these results together, there is evidence that banking sector liberalisation has taken place in both countries, but there is scope for further reform over time. Kenya and Rwanda are both more liberal in this sector than India, and Rwanda is also more liberal than South Africa—the only other Commonwealth developing country in the sample. In both cases, there is scope to look at a range of policy measures affecting the services trade environment, ranging from restrictions on foreign equity (particularly in Kenya's case) to barriers to competition (in both countries).

4.2 Distribution

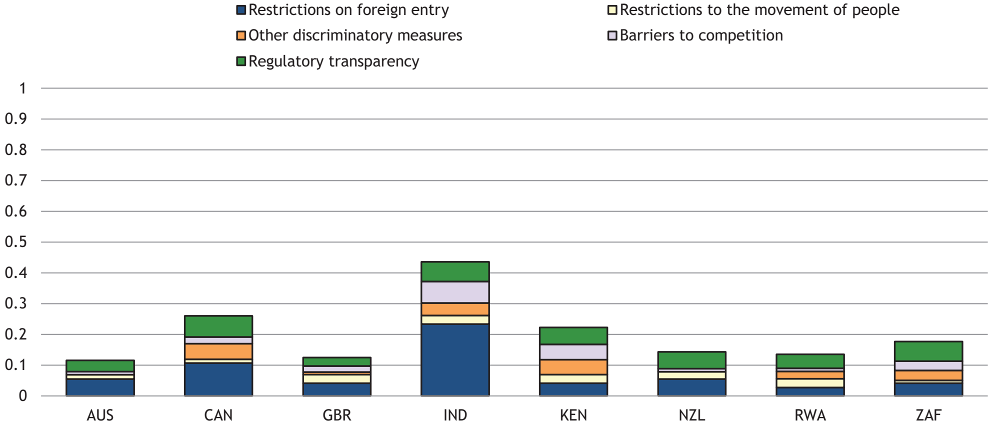
Figure 4.3 shows STRIs for the distribution sector for all countries. Kenya and Rwanda both show a low to moderate level of restrictiveness. Rwanda (0.14) is less restrictive than the sample average for this sector (0.19); Kenya (0.22) is only slightly above. Again, it is important to note that the sample average is largely composed of OECD

Figure 4.3 STRIs in distribution services, all countries, 2018 for Kenya and Rwanda, 2017 for others



Source: OECD, based in part on data supplied by the authors.

Figure 4.4 STRIs in distribution services, Kenya and Rwanda plu Commonwealth comparators, 2018 for Kenya and Rwanda, 2017 for others



Source: OECD, based in part on data supplied by the authors.

member countries. Comparing Kenya and Rwanda with other developing countries shows they are more liberal in this sector than Brazil (0.22), China (0.26), Indonesia (0.62) and India (0.45).

Figure 4.4 zooms in on Commonwealth countries for comparative purposes. Rwanda's STRI score of 0.14 for distribution is lower than those of Canada (0.26), India (0.44) and South Africa (0.18) among Commonwealth comparators.

Taking each group of measures separately, Rwanda's level of restrictions on foreign entry (0.03) is the lowest among the Commonwealth countries for which data are available, and Kenya's is equal second lowest (0.04).

Restrictions on movement of people are the same in both countries (0.03), and equal to what is observed in the UK and India, but higher than in other Commonwealth countries. As in the case of commercial banking, the reason is essentially related to the existence of labour market tests in both countries.

For other discriminatory measures, Kenya has the second highest score (0.05) among Commonwealth comparators, lower only than Canada (0.05; difference not apparent owing to rounding). Rwanda has a mid-range score (0.02), lower than South Africa (0.03), India (0.04) and Canada (0.05) but higher than the other Commonwealth countries in the sample. Both countries maintain public procurement regimes that favour local firms, which is recorded as part of the other discriminatory measures heading,[2] and Kenya also has differential tax treatment for foreign companies.

Restrictions in barriers to competition are equal second lowest among Commonwealth countries in Rwanda (0.02), whereas in Kenya (0.05) they are higher than other Commonwealth countries except India (0.07). The score in Kenya (0.05) is partly because of public sector involvement in distribution services (Uchumi Supermarkets), as well as the selective use of price controls, which restrict competition in the sector. All of these measures are restrictive, and so result in a higher score.

Finally, on regulatory transparency, Rwanda's score (0.05) is less restrictive than those of other Commonwealth countries except Australia (0.04) and the UK (0.03), but Kenya's score is mid-range within the Commonwealth, identical to that of New Zealand (0.05). The primary reason for the difference in the two countries' scores is that it takes much longer to obtain a construction permit in Kenya than in Rwanda, according to the World Bank Doing Business database: 159 days versus just 4. The length of time required to obtain a construction permit in Kenya is higher than the Sub-Saharan African average of 147.5 days.

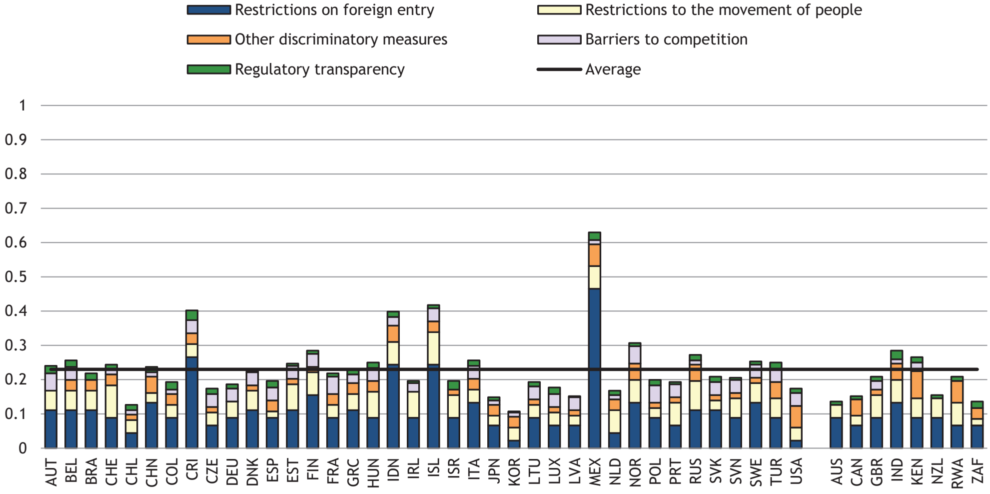
A similar issue for the distribution sector relates to customs procedure: imports take 3.6 days to clear the border in Rwanda, and there is no *de minimis* rule to exempt low value shipments; in Kenya, incoming shipments take 7.5 days to clear, and there is similarly no *de minimis* rule. The average clearance time for Sub-Saharan Africa is 5.7 days, so Rwanda's performance is stronger than regional peers but Kenya's is somewhat weaker. On the other hand, Kenya and Rwanda both have the obligation under their own laws to communicate regulations to the public within a reasonable time before entry into force, and have adequate public comment procedures open to interested parties. In addition, licences in relevant subsectors are awarded based on publicly available criteria. Positive measures such as these push regulatory transparency scores lower—that is, in the direction of indicating fewer restrictions.

Kenya and Rwanda both perform well in terms of policy restrictions affecting trade in distribution services. Rwanda in particular stands out for its low level of restrictiveness, but both countries are far less restrictive than the most closed Commonwealth market, that of India. The comparison across countries and groups of measures shows there is no strict relationship between services trade restrictiveness in this sector and per capita income. Indeed, Rwanda has the lowest income level of the Commonwealth countries considered, but overall a level of trade restrictiveness that is lower than average, and comparable to a liberally oriented developed Commonwealth country like New Zealand. Policy priorities relate to regulatory transparency, particularly time required to obtain permits, in Kenya, as well as public sector involvement in distribution and the use of price controls. In Rwanda, the environment is already quite liberal relative to other countries in the sample.

4.3 Road freight transport

Finally, Figure 4.5 presents results for the road freight transport sector for all countries. Kenya (0.27) is above average (0.23) in terms of its policy restrictiveness, whereas Rwanda (0.21) is below average. Given that the average is largely composed of OECD countries, it is appropriate to compare Kenya and Rwanda with other developing countries. Rwanda has a less restrictive policy environment than Brazil (0.22), China (0.24), India (0.28) and Indonesia (0.40), but is more restrictive than South Africa (0.14). Kenya's policies are more restrictive than developing country comparators other than India and Indonesia. In relation to both countries, middle-income Mexico (0.63)—which is an OECD member—stands out as having a much higher level of restrictiveness: the highest in the sample.

Figure 4.5 STRIs in road freight transport services, all countries, 2018 for Kenya and Rwanda, 2017 for others

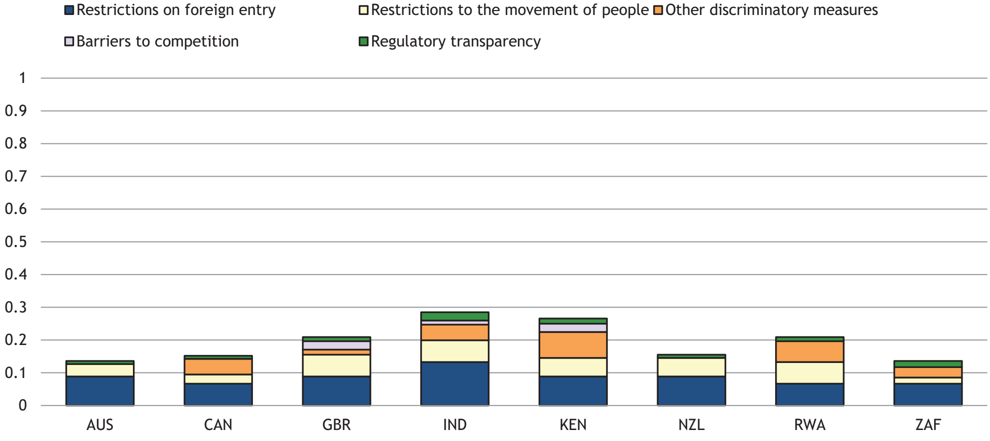


Source: OECD, based in part on data supplied by the authors.

Figure 4.6 extracts data for Kenya and Rwanda, along with their Commonwealth peers. Both countries are generally more restrictive than Commonwealth comparators, with the exception of India; Rwanda's STRI score in this sector is identical to that of the UK.

Taking each group of measures individually, restrictions on foreign entry in Kenya (0.09) and Rwanda (0.07) are generally in line with what is observed in Commonwealth comparators, and lower than in India (0.13). The key measures

Figure 4.6 STRIs in road freight transport services, Kenya and Rwanda plus Commonwealth comparators, 2018 for Kenya and Rwanda, 2017 for others



Source: OECD, based in part on data supplied by the authors.

in this area are again investment screening in Kenya, and restrictions on land ownership in both countries.

Restrictions on movement of people—0.06 in Kenya and 0.07 in Rwanda—are in line with the more restrictive Commonwealth countries in that category for this sector, such as the UK (0.07) and New Zealand (0.06). Scores again relate to requirements mentioned earlier, such as labour market tests.

Other discriminatory barriers are an area that deserves additional attention, as Kenya (0.08) and Rwanda (0.06) both have scores that are higher than those of all other Commonwealth countries. The reason is to be found in differential treatment of foreign businesses under public procurement policies in both countries, and differential tax treatment in Kenya.

In relation to barriers to competition, Rwanda has a score of 0, indicating no restrictions, which is the same as Australia, Canada, New Zealand and South Africa among Commonwealth comparators. Kenya's score of 0.03 is identical to that of the UK. The reason for Kenya's score is price regulation as well as an exemption from transit tolls for locally registered vehicles only in Kenya—that is, road tolls are applied in a way that discriminates against foreign service providers.

Kenya and Rwanda both again show a low to moderate level of policy restrictions in the road freight transport sector, with the environment being more conducive to trade in Rwanda than in Kenya. Although both countries have a relatively liberal stance, they are noticeably more restrictive than, for example, South Africa. While restrictions on foreign entry there are similar, policies in all other areas are less restrictive. Given the importance of road freight transport as a services sector that promotes connectivity, particularly for a landlocked country like Rwanda, it will be important for policy-makers to critically examine the current regulatory stance, as well as practice elsewhere in the region, to see if there is scope for further progress.

4.4 Regulatory heterogeneity with Commonwealth partners

Nordas (2017) shows that the data from the STRI project can be used not only to measure restrictiveness but also to calculate summary measures of regulatory heterogeneity between countries within sectors. Whereas the STRIs are one number per country per sector, measures of heterogeneity are bilateral—that is, they take account of regulations in each country of a pair. OECD calculates two measures of regulatory heterogeneity, one based on differences in scores between countries and the other based on differences in answers to the regulatory questionnaire between countries. The latter approach is used, but indices using differences in scores are also available on request.

The essence of the methodology, as set out in Nordas (2017), is to look at answers to individual questions in the regulatory questionnaires used to build the STRIs. Concretely, the methodology proceeds by creating a matrix where each cell corresponds to a specific answer in the database for a pair of countries. If a country pair has the same answer to a question, the cell is recorded as 0. If they have different answers, it is recorded as 1.

The heterogeneity index is then calculated as a weighted average of the scores in each cell, using the same weights as in the STRIs themselves. To be clear, the index captures regulatory differences in a non-evaluative way: a low score does not indicate that one country's regulations are 'better' than another's in any meaningful way. Rather, the index is an attempt to capture in a rigorous quantitative way the data underlying the widespread belief that regulatory differences contribute to trade costs in services sectors.

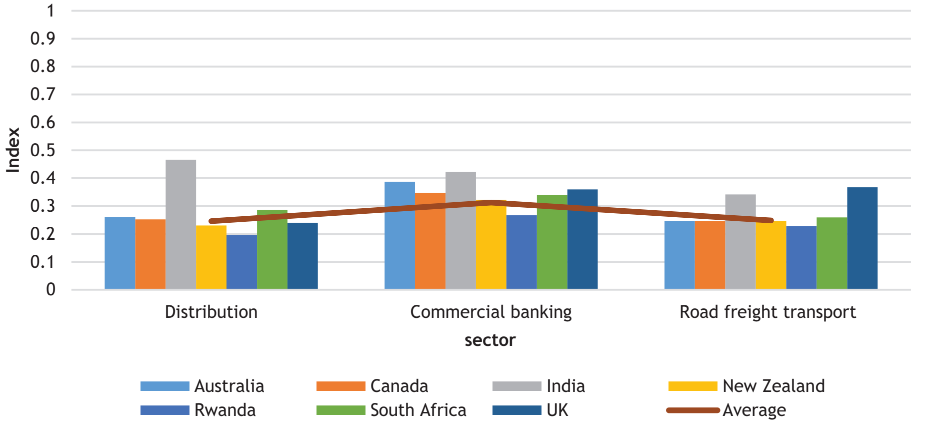
Indeed, Nordas (2017) finds that reducing regulatory heterogeneity by 0.05 points is associated with 2.5 per cent higher services exports, while an average heterogeneity scores of 0.26 is associated with *ad valorem* equivalent trade costs of between 20 per cent and 75 per cent at low levels of the STRI.

For Kenya and Rwanda, the OECD has calculated regulatory heterogeneity measures for each sector with respect to every other country in the full sample. For each country, there are therefore 3 sectors multiplied by 45 partner countries, giving 135 index scores with partners for each of the 2 countries. Appendix 3 reproduces the matrix of scores in full. It is not practical to reproduce the full matrix of heterogeneity at the level of individual measures, as that would entail 538 measures multiplied by 45 partner countries, giving a total of 24,210 scores per country.

To summarise the results of this computationally intensive exercise, graphical methods are used, as for the STRIs themselves. A taller bar indicates a higher heterogeneity score with the country concerned. For comparative purposes, the focus is on the two countries in relation to their Commonwealth peers, with the sample average score by sector also reproduced.

Results for Kenya are in Figure 4.7. Each bar represents regulatory heterogeneity with a particular Commonwealth trading partner, while the line is the average heterogeneity score across all countries in a particular sector. Unsurprisingly, Kenya's regulatory heterogeneity score in all sectors is lowest with Rwanda. This finding suggests that

Figure 4.7 Regulatory heterogeneity indices by sector, Kenya and Commonwealth partners, 2018 for Kenya and Rwanda, 2017 for others



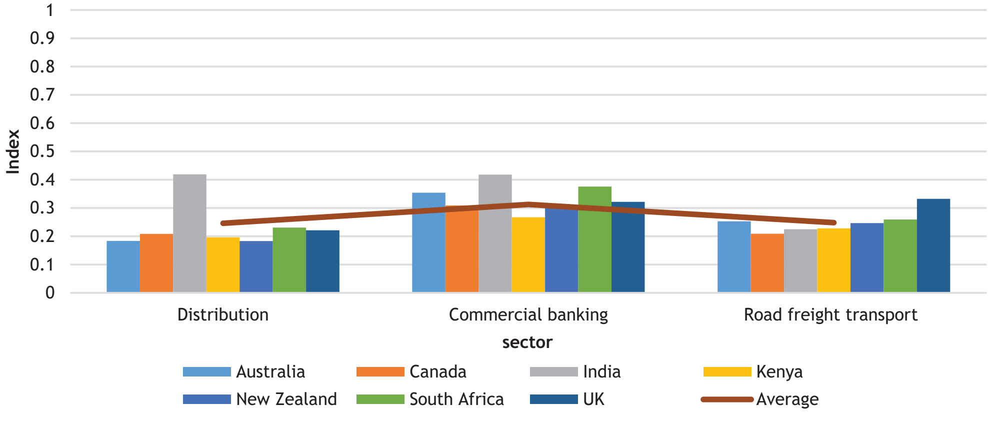
Source: OECD, based in part on data supplied by the authors.

substantial harmonisation has taken place between the two countries within the context of the EAC CMP. To put these results in perspective, however, compare heterogeneity between Kenya and Rwanda in one sector, such as distribution, with scores for EU member states in the same sector. Kenya's heterogeneity score with Rwanda in distribution is 0.196, whereas the lowest intra-EU score, between the Czech Republic and the Slovak Republic, is 0.084. Of course, regulatory heterogeneity varies substantially within the EU, so countries like Germany and Luxembourg, or the Slovak Republic and Sweden, have scores that are comparable to what is observed in Kenya and Rwanda. These findings suggest there is likely substantial space within the EAC to increase regulatory harmonisation among member countries as one way of reducing trade costs, but that the process is very complex from a political economy perspective. Substantial regulatory differences remain even in a setting like the EU, which has been harmonising regulations over a substantially longer period.

In distribution, Kenya's scores are lower than average with respect to New Zealand, Rwanda and the UK, and close to average with the remaining Commonwealth countries except India. In commercial banking, only the score with Rwanda is below the sample average; scores with other Commonwealth countries except India are only slightly higher than average. Finally, in road freight transport, regulatory heterogeneity is lower than average with Australia, Canada, New Zealand and Rwanda, only slightly above average in South Africa and higher than average in the remaining countries.

Figure 4.8 shows comparable results for Rwanda. Whereas Rwanda was always the partner with the lowest heterogeneity index for Kenya, the same is not always true for Rwanda itself. In distribution, its regulations are more aligned with those in Australia and New Zealand than those in Kenya, while the same is true for Canada and India in the case of road transport. This finding supports the judgment above that there is still considerable room to move forward on regulatory harmonisation within the framework of the EAC CMP.

Figure 4.8 Regulatory heterogeneity indices by sector, Rwanda and Commonwealth partners, 2018 data for Kenya and Rwanda, 2017 for others



Source: OECD, based on data supplied by the authors.

In distribution services, Rwanda's scores with all Commonwealth countries except India are lower than the average. In commercial banking, its index score with Kenya, Canada and New Zealand is lower than average; its score with the UK is just above the average; and its score with other countries is higher than average. In road transport, its score with Canada, India, Kenya and New Zealand is lower than average and that with South Africa and Australia is just a little higher than the average; only the score with the UK stands out as substantially higher than average. Overall, Rwanda's average regulatory heterogeneity index scores with Commonwealth partners are lower than Kenya's. This suggests the component of its services trade costs linked to differences in regulatory stance across countries is lower, and correspondingly that it is therefore better able to access foreign markets.

Results from the regulatory heterogeneity exercise suggest there has indeed been some regulatory convergence within East Africa, as would be expected, given the nature and structure of the EAC CMP. However, the process is ongoing and not complete. Interestingly, there is also some degree of regulatory convergence with other Commonwealth countries. This process has clearly taken place outside the strict framework of trade agreements, and likely represents deeper factors like institutional and legal similarities among member countries. However, that process has been stronger in Rwanda than in Kenya, and in particular in the distribution sector, and to a lesser extent road transport.

Notes

1 It appears that Kenyan authorities rarely apply this test in practice to screen investment, but it remains on the statute book. Consistency therefore requires that it be coded as a restriction, so that results are comparable with other countries, like Australia and Canada, which have a screening regime in law even though it is rarely used to stop investments in practice.

2 Local firms appear not to believe they are favored in procurement decisions in practice. However, the restriction is recorded in the laws of both countries, so it is coded accordingly.

Reference

Nordas, H. (2017) 'Services Trade Restrictiveness Index (STRI): The Trade Effect of Regulatory Differences'. Trade Policy Paper 189. Paris: OECD.

Chapter 5

Complementing the STRI: Data on *de facto* Constraints Affecting Services Firms in Kenya and Rwanda

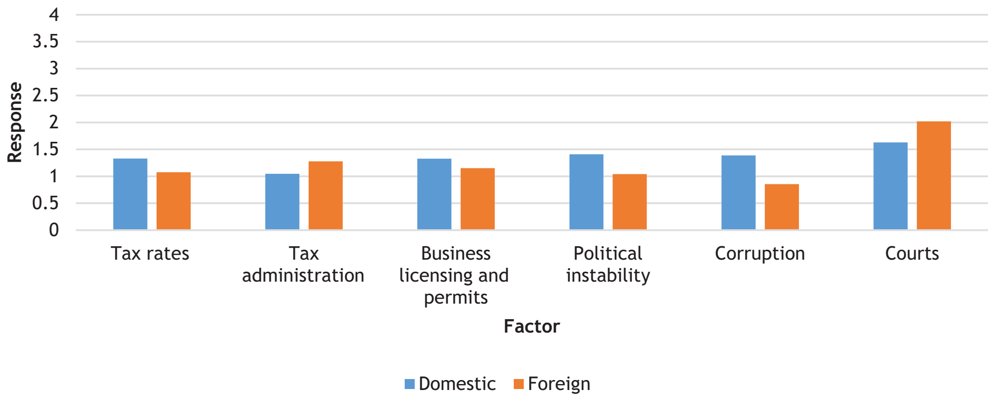
By its nature, the STRI methodology focuses on *de jure* barriers to services trade, in the sense of well-defined legal restrictions that make it more difficult for service providers to enter markets, or to do business there once they do. This focus is entirely appropriate, and reflects the fact that the trade policy community—government, researchers and civil society—is concerned primarily with working collaboratively to improve the policy framework within which business takes place. Trade agreements, whether multilateral like the WTO or regional like the EAC, typically focus on *de jure* restrictions.

However, the business community sometimes emphasises that laws do not represent the full extent of the barriers they face in building and growing their activities. Particularly in countries with serious capacity constraints, there can be a large gap between laws and regulations on the one hand and widespread practices on the other. This study is not primarily about quantifying this second group of issues, but, in the interests of promoting a wide-ranging dialogue, it is possible to present some data from an alternative source that goes some way towards showing the kinds of difficulties services firms in Kenya and Rwanda encounter beyond purely legal ones. The objective here of presenting these additional data is to complement what is in the STRIs, not to take away from those findings in any way.

The World Bank Enterprise Surveys project has surveyed 131,000 firms in 139 mostly developing and transition countries. It covers services as well as manufacturing. The focus here is on surveys of formal sector firms, as this scenario is of most interest to foreign service providers. Note that additional data are available on informal sector firms.

In addition to collecting standard data on firm activities and performance, the survey has a series of questions that ask senior managers to rate the seriousness of various constraints they face in the general business environment. The constraints are shown to them in a random order. These questions go directly to the heart of the kinds of *de facto* barriers sometimes stressed by the business community. This study therefore reviews the available data for Rwanda and Kenya, based on surveys conducted in 2011 and 2013, respectively. A distinction is made between business constraints identified by domestic firms and those identified by foreign-invested firms (defined as those with at least 50 per cent foreign ownership). The reason for this is to shed light not only on the general constraints that services businesses face in the two countries but also on any differential effects between local firms and foreign entrants (the sales of which are, subject to small differences in statistical treatment, effectively Mode 3 imports).

Figure 5.1 Average responses of Kenyan firms on the seriousness of particular business constraints as an obstacle to current operations, 2013, index (0–4)



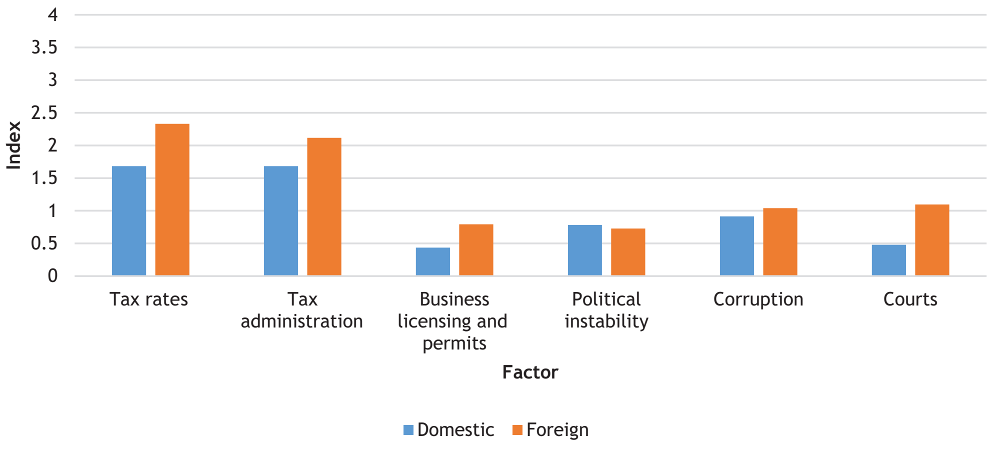
Source: World Bank Enterprise Surveys; authors' calculations. Note: Averages apply sampling weights included in the dataset. Foreign firms are those with at least 50 per cent foreign ownership. Based on the scale in the questionnaire: 0 indicates no obstacle, 1 indicates a minor obstacle, 2 indicates a moderate obstacle, 3 indicates a major obstacle and 4 indicates a very severe obstacle.

The Kenyan Enterprise Survey covers 367 services firms. Figure 5.1 presents results. The most striking feature is that, of the six listed constraints, all are considered minor to moderate obstacles. Interestingly, domestic and foreign-owned firms alike consider the court system to be the most serious constraint to their current operations. This suggests there may indeed be some *de facto* problems in terms of the business environment, in the sense that, although legal obligations may be clear through either regulation or private contract, enforcing them may be more complicated and uncertain.

Comparing results for locally owned and foreign-owned firms is also instructive. Only in the areas of tax administration and the court system do foreign-owned firms report that the relevant factors are more of a business constraint than is the case for local firms; in the other cases, the level of constraint facing foreign-owned firms is noticeably less. In part, this is likely a factor of size, as firms with a significant share of foreign ownership are typically larger than their locally owned counterparts, and thus more able to absorb the costs associated with navigating the business environment. Nonetheless, there is some evidence that foreign-owned service providers have more difficulties with the court system and with tax administration than do local firms, with this rising in the former case to the level of a moderate obstacle to ongoing operations. Again, these findings highlight the complementary importance of *de facto* restrictions on doing business that sit beside the STRI when conducting a full analysis of the environment for foreign service providers within a country. This information is highly complementary, as it suggests that, although Kenyan laws are not overly restrictive by international standards, the position on the ground may be more challenging in some areas for foreign firms.

The Rwandan survey uses a smaller sample than the Kenyan one, by virtue of the country's smaller size. It covers 160 services firms. Figure 5.2 presents results. The first

Figure 5.2 Average responses of Rwandan firms on the seriousness of particular business constraints as an obstacle to current operations, 2011, index (0–4)



Source: World Bank Enterprise Surveys; authors' calculations. Note: Averages apply sampling weights included in the dataset. Foreign firms are those with at least 50 per cent foreign ownership. Based on the scale in the questionnaire: 0 indicates no obstacle, 1 indicates a minor obstacle, 2 indicates a moderate obstacle, 3 indicates a major obstacle and 4 indicates a very severe obstacle.

point that stands out is that tax is more of an issue for Rwandan firms than it is for Kenyan firms, in terms of both rates and the way in which it is administered. In both cases, the obstacle rises in seriousness to the moderate level for foreign firms.

The second point to emerge is that foreign firms in nearly all areas report a higher level of business obstacles than do their locally owned counterparts. Although business licensing and the court system are not major obstacles to business, the difference in perception between locally owned and foreign-owned firms is striking. Having said that, the absolute levels at which obstacles are assessed in all areas other than tax suggest that the business climate in Rwanda is in fact very accommodating, including to foreign-owned service providers. In all cases except the two tax questions, business obstacles are rated lower in Rwanda than in Kenya. This is in keeping with results from the STRI, which suggest a generally supportive policy environment in the services sectors studied, and one that is more liberal than in nearby Kenya.

Taking the results for the two countries together, there are indications that, although the business environment, particularly in Rwanda, is generally supportive of services firms, it is in most cases more difficult for foreign service providers to navigate rules and procedures than it is for locally owned firms. In part, this may reflect information costs, but, if so, there is a role for increased transparency in promoting a shared understanding of rules and procedures among all firms, irrespective of origin. While trade agreements will continue to focus on the types of *de jure* restrictions highlighted in the STRIs, it is important to look at how these policies and regulations interact with the environment on the ground to produce observed outcomes in terms of trade and investment. Policy-makers can leverage both sets of results in a complementary way to support a dialogue with local firms and foreign providers in the interests of creating a level playing field that supports competitiveness, productivity upgrading, structural transformation and increased regional and global integration of services markets.