Chapter 5

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

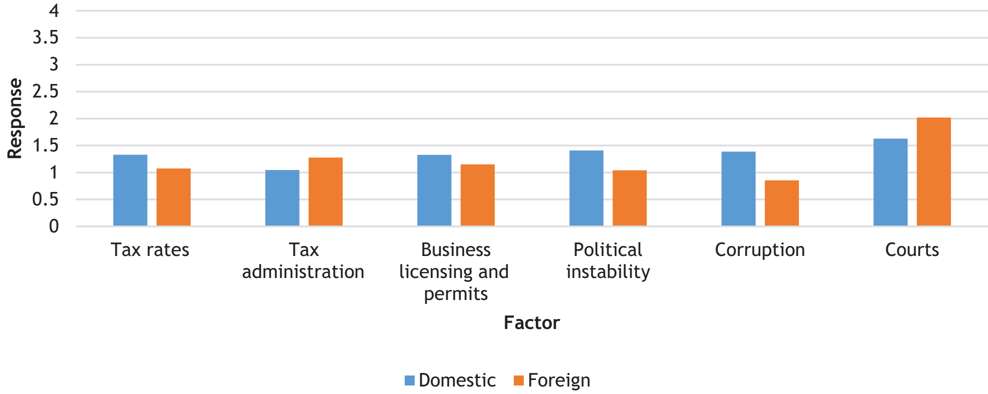
By its nature, the STRI methodology focuses on *de jure* barriers to services trade, in the sense of well-defined legal restrictions that make it more difficult for service providers to enter markets, or to do business there once they do. This focus is entirely appropriate, and reflects the fact that 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)



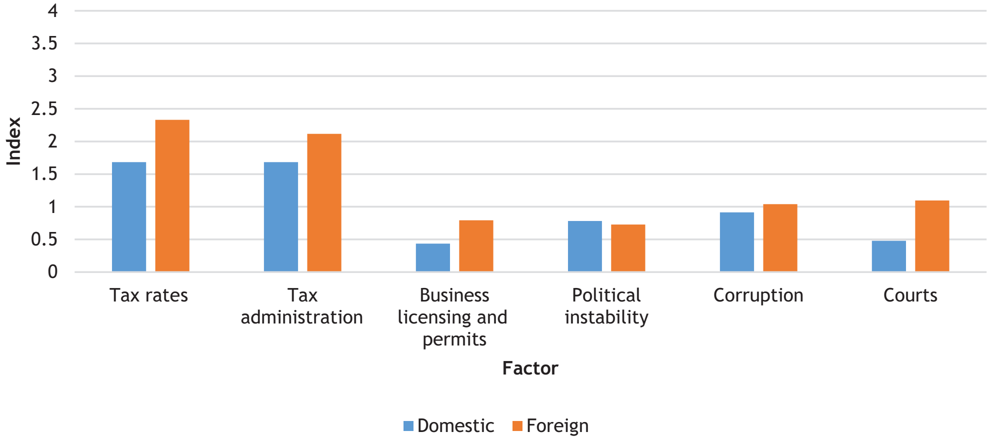
Source: World Bank Enterprise Surveys; authors' calculations. Note: Averages apply sampling weights included in the dataset. Foreign firms are those with at least 50 per cent foreign ownership. Based on the scale in the questionnaire: 0 indicates no obstacle, 1 indicates a minor obstacle, 2 indicates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