Chapter 6

Conclusion and Policy Implications

Services are becoming more important to trade and production all over the world. Kenya and Rwanda, particularly the latter, are by no means exceptions to this general pattern. In addition to their presence in direct exports, services are also increasingly embodied in manufactured goods that are in turn exported. Key backbone services like transport, communications, logistics and distribution, and finance are therefore vital for countries looking to compete in world markets.

The findings presented in this publication are based on new data on services trade policy restrictions in Kenya and Rwanda covering commercial banking, distribution and road freight transport. These sectors were chosen because of their economic importance to the two countries, which is reflected in the prominence given to them in policy and strategy documents from the region. These results are a clear testament to the feasibility and policy interest of collecting data on services trade restrictions in developing countries and LDCs.

Data on policies affecting services trade are out of date or not available at all for many Commonwealth countries. As a result, research and policy analysis of services is greatly hampered, and it is more difficult for businesses to assess the regulatory environment overseas as it affects their ability to sell into foreign markets. Given these major knowledge gaps, we have shown that well-established methodologies exist that can help close these gaps.

Developing a competitive services sector is an important part of structural transformation in developing countries, including Kenya and Rwanda. Sectors like the three examined here can be produced and exported directly, but are also used intensively by other sectors, particularly manufacturing. Without competitive services offerings in these key areas, it will be difficult for downstream firms to themselves be productive and win export market share.

To systematically record and quantify policy restrictions affecting the selected services markets, this study has adopted the approach used by the OECD in creation of their STRI. The advantage of using an established methodology is that results are directly comparable with what has already been collected for other countries. In addition, there is an existing, rigorously tested, body of knowledge in relation to weighting and aggregation of individual policies into summary STRIs. By leveraging this knowledge and experience in the present project, it has been possible to focus on the most relevant policies, and thus collect and analyse the necessary data rapidly and at reasonable cost.

Results from the exercise are highly informative. In all three sectors, Kenya and Rwanda have low to moderate levels of policy restrictiveness compared with the other countries for which data are available, and are typically less restrictive in their policy settings than major developing countries. Rwanda stands out as having a relatively liberal policy stance, as it is less restrictive than observed on average across all countries for which data are available in distribution and road freight transport, and only a little more restrictive than average in commercial banking. In commercial banking and distribution, policy settings in both countries are reasonably comparable to what is seen in higher-income South Africa.

Looking more closely at particular types of policies that affect services trade, it is clear that a number of the most important factors that push Kenya's and Rwanda's STRI scores above what is seen in high-income Commonwealth comparators are in fact cross-cutting issues, rather than sector-specific ones. On the positive side, entry by foreign firms is not highly restricted in either country, and common restrictions some other developing countries apply, such as restrictions on repatriation of profits, are absent. Nonetheless, Kenya applies a discretionary test based on economic need, which could have the effect of discriminating against foreign firms; although investments are rarely rejected in practice, the legal capacity to do so reduces business certainty and could still negatively affect services sector investment. For movement of people, both countries apply labour market tests that require, for example, that a company be unable to fill a vacancy locally before it can resort to a foreign service supplier or intra-corporate transferee. Other cross-cutting discriminatory measures include public procurement in both countries, which is designed to favour local firms, and a difference in tax treatment of foreign and local businesses in Kenya. Regulatory transparency is an interesting point of contrast between the two countries: whereas licences for activities like construction are delivered quickly in Rwanda, much longer delays tend to be the norm in Kenya. The latter country could benefit from reducing these delays.

Whereas economists typically suggest that countries flatten and gradually reduce their tariff schedules in goods markets, advice for services markets is much more complex. The reason is that it is regulatory measures, not simple discriminatory taxes, that are an issue. This report has shown that both countries have some restrictive measures. However, before reforms can be undertaken, it is important to arrive at a clear assessment of the costs and benefits of existing regulations relative to feasible alternatives. Such an exercise is not conducted here but, as a result of the data collection and coding process at the core of the STRI, both countries are now better placed to conduct it themselves. As a general proposition, some may see cases of direct discrimination against foreign service providers as justified because they support local industrial development, or small and medium enterprises (SMEs) in particular: this is a traditional argument for protection. It is likely, however, that alternative policies with lower economic costs are available, such as SME-specific improvements in the business and investment environment, or even certain targeted subsidies. This is not to suggest a wholesale repeal of the measures coded in the STRI as restrictive, simply that they be assessed rigorously for the economic costs and benefits, including their effects on international trade.

A key point of comparison for this pilot will be results from the World Bank–WTO STRI update. It is not currently clear when the launch date for results from this project will be, but it will be important to engage with the project team to ensure their data (gathered from law firms via surveys) are comparable with those presented here (collected directly). Also, we understand that that project intends to aggregate results using the OECD and World Bank methodologies, which will provide two different cuts of the data. Broadly speaking, the OECD STRI includes a wider range of policy measures than the World Bank STRI, which focuses more closely on measures that explicitly discriminate against foreign providers. It is important for measurements of services trade restrictiveness to also take account of selected non-discriminatory measures that increase the real resource cost of doing business. But, ultimately, there is an empirical question to be answered as to which approach yields the best results in terms of explaining trade flows and other economic impacts. Comparing the results here with the broader dataset assembled by the World Bank–WTO project will therefore be an important analytical priority in the future.

Moving forward, the intention of this study is to provide a point of departure for engagement with policy-makers and stakeholders in Kenya and Rwanda. A key final step in production of the STRIs is validation by the two governments, which it is hoped will take place during 2018. In addition, this will enable the recording of views expressed by government and firms (local and foreign) in terms of the *de jure* and *de facto* restrictions on services trade in the three sectors under consideration here. Although this study has taken some first steps towards loosening the data constraint in relation to laws and regulations affecting services trade, a matter of vital importance for both countries will be the development of capacity to record disaggregated trade in services data. Empirical researchers, as well as policy-makers and stakeholders, in both countries would benefit greatly from this development.

As members of the EAC, Kenya and Rwanda are both moving forward to liberalise trade not only on an MFN basis but also specifically within the region. The Scorecard process, which tracks progress, is a very positive step for transparency. Although this analysis is based on MFN, not regional, policies, both countries could benefit greatly from redoubling their efforts to reduce or eliminate the barriers to intra-regional services trade identified in the EAC Scorecard.

6.1 Key findings

The key findings from the application of the STRI to commercial banking, distribution services and road freight transport services within the Commonwealth beginning with Kenya and Rwanda can be summarised as follows:

- **Economic contribution of services trade:** Commonwealth member countries rely heavily on services as a source of economic activity, employment and foreign exchange earnings, but data on flows and information on policy barriers remain extremely limited. An absence of clear and transparent information on policy and regulatory frameworks can impede services trade flows and hold back analytical work.
- **Services trade policy barriers:** It is possible to apply best international practice as embodied within the OECD's STRI framework to the developing Commonwealth,

which involves a detailed review process of legal and regulatory frameworks at the sectoral level, as well as consultative processes with governments directly, as opposed to responses received from law firms in country.

- **Trade-related effects:** It is possible to derive estimations for services trade barriers and their level of restrictiveness *vis-à-vis* other OECD members. Applying best practice to the measurement and identification of policy barriers to services trade within the Commonwealth could boost trade and investment, including intra-Commonwealth flows, and help reduce regulatory heterogeneity, which in turn lowers services trade costs.
- **Regulatory heterogeneity:** Kenya's regulatory heterogeneity score in all three sectors is lowest with Rwanda. This finding suggests that substantial harmonisation has taken place between the two countries within the context of the EAC CMP. Overall, Rwanda's average regulatory heterogeneity index scores with Commonwealth partners are lower than Kenya's, which suggests that the component of its services sector trade costs linked to differences in regulatory stance across countries is lower, and correspondingly that it is better able to access foreign markets.

6.2 Recommendations

In terms of recommendations, the following can be formulated based on a review of the evidence in the three sectors under consideration:

1. **Trade statistics:** Develop the capacity to track services trade by partner country and sector. This information is a vital input into any serious analytical work on services trade, and is a necessary precursor to statistical analysis that could support policy change to facilitate trade, and enable analysis of trade effects induced through services trade policy changes.
2. **Expand STRI coverage:** The pilot has clearly established the feasibility and interest of calculating STRIs for developing Commonwealth countries. However, overall, 22 sectors are included within the STRI, ranging from the digital network (computer services, telecommunications, broadcasting, motion pictures, sound recording), transportation and distribution supply chain (air, maritime, road freight and rail freight transportation, courier services, distribution services, cargo-handling, storage and warehouse, freight forwarding, customs brokerage), market bridging and supporting services (legal services, accounting services, commercial banking, insurance), to physical infrastructure services (construction, architecture services, engineering services), for 44 countries covering 80 per cent of global services trade. Expanding the initiative to cover additional sectors and developing Commonwealth members would help improve the quality of economic policy-making, and facilitate trade both within the Commonwealth and the rest of the world.
3. **Use the STRIs as a basis for regulatory audits:** This study has collected a large amount of data on regulatory measures affecting services trade in three sectors.

Considerably more could be collected over time if the study is expanded. An important use of the data is to examine current regulatory measures, and undertake a rigorous cost-benefit assessment of them. The aim should be to develop a regulatory structure that is effective, in the sense that it achieves important social goals, and efficient, in the sense that it does so at minimum economic cost, including disruptions to international trade. Looking at alternative regulatory measures that could achieve the same goals but with lower economic costs is an important part of the process. The OECD's STRI database provides a rich source of practice in other countries that can be drawn on to inspire local reforms.

4. **Regulatory transparency:** 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.

5. **Leverage regional initiatives:** The EAC has a well-established set of priorities in services, which in some cases can also support relaxation of MFN policy measures. The EAC Scorecard is a very positive initiative to promote transparency, so both countries should press forward with reforms aimed at eliminating the barriers identified in the Scorecard. The EAC CMP is also a positive platform for promoting regulatory harmonisation. The data suggest that Kenya and Rwanda could both benefit more from reducing differences in key regulations with their trading partners, including intra-regionally.

6. **Address cross-cutting policies:** Some of the key policy restrictions identified here are cross-cutting in nature, which is not unusual in the developing country context; indeed, compared with other developing countries for which data are available, Kenya and Rwanda do not have overly restrictive cross-cutting measures, as a general rule. Engaging with stakeholders and partners to envisage ways of reducing discrimination against foreign service providers could yield significant economic benefits by facilitating additional investment, people movement and cross-border trade.

7. **Engage with stakeholders to address sector-specific policies:** The analysis here has also highlighted some sector-specific policies that contribute to restrictiveness in the two countries. Reform requires detailed analysis and consultation. But issues like discriminatory tolls for road freight transporters, and public sector involvement in commercial banks and distribution companies, could benefit from further consideration with the aim of ensuring effective and efficient sectoral regulations.

8. **Further incorporate the services dimension into development strategies:** Both countries already recognise the importance of services as an agent of structural change. But in the absence of trade in value added data, the contribution of services to exports in other sectors, particularly manufacturing, is not well understood. It is difficult to compete in world markets without competitive backbone services sectors. Developing this understanding and highlighting the ability of services

to support structural change, income growth and development will be key to moving forward on a broad based agenda to leverage services as one part of the two countries' overall economic strategies. Moving forward on this agenda item would also support future trade policy reforms, and would position the countries more actively in services negotiations in regional and multilateral forums.

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