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Promoting Rwanda's business environment: Impact of reforms and drivers of change

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[Correction added on 19 February 2022, after first online publication: The affiliation of Ruth Hoekstra has been updated.]

Summary

Motivation: Despite its status as a low-income country in an unfavourable location for economic conduct, and being overshadowed by the devastating genocide of 1994, Rwanda has been recognized for its efforts to improve its business environment via several reforms and regulations according to various indicators.

Purpose: We contribute an analysis of the extent of improvements which Rwanda's regulatory reforms have yielded in the business environment. We also identify four interconnected drivers of change which account for the government's capability to implement successful reforms in the economy.

Methods and approach: We adopt a quantitative and qualitative approach.

Findings: We find that Rwanda's regulatory reforms in the business environment are rather a mixture of true progress and window dressing. The drivers of change accounting for the progress in Rwanda's economy are the pressure on the government to generate economic growth, the country's leadership, the pre-colonial institutional framework, and Rwanda's aid effectiveness.

Policy implications: The close interconnectedness of political and economic entities makes it inefficient to implement integral changes to Rwanda's current system. The Rwandan government should rather credibly commit to its own policies and developmental approaches and continue its progress in private sector transformations without crowding out small- and medium-sized enterprises.

KEYWORDS

business regulations, developmental state, Rwanda

1 | INTRODUCTION

Rwanda would not at first sight seem to be a showcase of regulatory reform. After the genocide against the Tutsi in 1994, in which an estimated 500,000 to 800,000 people were killed (Des Forges, 1999), the country was left with a much-reduced human capital base, destroyed institutions, and an economy without prospects. Even today, as a landlocked

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country in a region characterized by instability and conflict, Rwanda faces unfavourable conditions for economic conduct. With a per capita income of USD 830 in 2019 (World Bank, n.d.-a), it remains one of the world's least developed countries.

Even so, the Government of Rwanda (GoR) worked intensively to improve its regulatory quality within a broad reform agenda to create incentives for doing business and to market the business environment as a benevolent and modern setting for domestic and international companies alike. It extensively cut the level of corruption and promoted financial inclusion to encourage citizens to develop an entrepreneurial mindset and to thus shift labour from the relatively large informal economy to businesses in the formal economy (FinScope, 2020; Honeyman, 2016). As a result of several regulatory reforms and legislative amendments, the country now easily surpasses the average low- and middle-income country (LMIC) in its regulatory quality and government effectiveness (Kaufmann & Kraay, 2020), ranks globally in 38th place for its ease of doing business (World Bank, 2019a), and is the second-best place to do business in sub-Saharan Africa (herein after referred to as Africa).

Due to its framework for development, *Vision 2050*, all reforms are deeply embedded within Rwanda's concept of development to transform itself into a knowledge-based upper middle-income country by 2035, and into a high-income country by 2050 (Republic of Rwanda, 2019). From 1995 to 2019, Rwanda's annual per capita growth rate averaged 6% (World Bank, n.d.-a), becoming one of the fastest-growing economies in the world. In the literature, Rwanda is often associated with the "developmental state" approach due to this fast-paced progress (Booth & Golooba-Mutebi, 2012; Goodfellow, 2017; Hasselskog, 2018; Honeyman, 2016; Nwapi & Andrews, 2017).¹

Further academic research and indices, such as the World Economic Forum's *Global Competitiveness Report*, have built upon Djankov et al.'s (2002) entry regulation indicators, which found that easier regulation of new businesses is also associated with increased competition and economic growth. For example, Djankov (2009) marks that easier entry to the market increases entrepreneurship and productivity while reducing corruption levels. Klapper and Love (2014) show that reforms need to either have a certain magnitude or work in synergy to exert a significant impact on new firm registrations. Empirically, countries which impose stricter market-entry regulations need larger reforms to boost the number of new registrations. Rwanda, for example, has implemented several reforms to stimulate the business environment and to lower market-entry regulations (World Bank, n.d.-b). Conversely, public interest theory attributes the formation of monopolies, rent extraction and externalities to markets without a sufficient level of regulation (De Soto, 1990; Pigou, 1932; Shleifer & Vishny, 1998).

Rwanda's economic and, in turn, its regulatory progress is remarkable in its post-genocide setting. Hence, we aim to analyse the extent of improvements which Rwanda's regulatory reforms have yielded in the business environment and how the GoR manages to implement successful reforms. To do so, we first examine the state of Rwanda's current business environment, drawing on the Worldwide Governance Indicators, the Doing Business Indicators, and the Global Competitiveness Report. As there is reason to believe that the success of reforms might be overstated, we then turn to an impact analysis of selected reforms. Here, we critically evaluate, inter alia, the extent of the regulatory improvements for setting up a company, as well as the accuracy of their impact on the economy. Several reasons for Rwanda's growth path have been subject to academic research, but generally in isolation. Hence, we finally analyse qualitatively how four specific drivers of change contribute to the facilitation of implementing growth-enhancing regulations in the unique Rwandan setting, and on their strong interconnectedness.

¹The early theory of the developmental state was developed by Johnson (1982), who identified four distinct features to explain the economic development of East Asia after the Second World War: (1) a small elite bureaucracy, which is in charge of picking and fostering economic winners; (2) a political framework fitted to the elite, without allowing interference from vested interest; (3) growth-enhancing state intervention in the economy; and (4) an agency within the bureaucracy to co-ordinate and implement industrial policies.

2 | THE SCOPE OF REGULATORY REFORMS

From the late 1990s, Rwanda has paid great attention to rebuilding the economy and ameliorating its business environment through extensive regulatory reforms. Ever since, the government has maintained significant control over its economic liberalization and modernization policy agenda. The GoR has improved the effectiveness of policy implementation, as measured by the Worldwide Governance Indicators, from -1.15 to 0.19 between 1996 and 2019 and the regulatory quality from -1.34 to 0.08 over the same period.² Rwanda also displays a far better control of corruption than the average LMIC or African country.³

This positive development is also mirrored in the World Bank's Doing Business Indicators, which are used by the GoR as a guideline to improve and evaluate its reform programmes within the scope of its long-term development strategy *Vision 2050* (Solf et al., 2020). Although the Doing Business Indicators have been criticized for reflecting de jure rather than de facto improvements of the business environment (Holden & Pekmezovic, 2020; Veit & Streege, 2012),⁴ they are "useful as political economy tool to spur reform[s] related to encouraging private sector development" (Holden & Pekmezovic, 2020, p. 259). This data set is thus still able to depict whether a country is actively implementing growth-enhancing business reforms. *Doing Business 2019*, for example, lists Rwanda among the top 10 countries with most notable improvements in business reforms, and it was deemed a top reformer in 2009 (World Bank, 2009, 2018). Early business reforms after the genocide included macroeconomic stabilization, privatization of state enterprises, as well as rebuilding infrastructure and the economic and financial institutions (Investment Climate Advisory Services, 2010). Lately, the reforms include an additional focus on the building up of human capital and establishing an entrepreneurial mindset among its citizens. For example, Rwanda has put a mandatory entrepreneurship course into action, which runs for all six years of secondary school, and frequently creates incentives to formally register companies (Honeyman, 2016). Today, Rwanda, together with Slovenia, is the only country in which the costs for starting a business amount to zero, while it takes only four days to open a business (World Bank, n.d.-a). Due to this promising regulatory setting, it has even surpassed the average high-income country, not only in its ease of starting a business but also in its overall ease of doing business (Table 1).

Especially in comparison to other African or LMICs, Rwanda performs exceptionally well. Over the last years, it facilitated doing business by implementing regulations that eased bureaucratic processes, for example, online services for property and business registrations and for filing and paying taxes, as well as reducing the access barriers for electricity and internet connectivity (World Bank, n.d.-b). This is also in line with Rwanda's plans to become a hub for information and communication technology (ICT). As Rwanda directs aid flows towards productive investment and public services, businesses and private individuals alike profit from improvements in infrastructure, which facilitate trade and attract foreign companies. Hence, the GoR focuses on boosting the business environment especially for new businesses, which is mirrored in Rwanda's above-average performance in the ease of getting credit, registering property, and starting a business in general (Table 1). In addition, Rwanda exempts newly formed small- and medium-sized enterprises (SMEs) from paying the trading licence tax for the first two years of operation and suspends further tax payments for ICT companies (Republic of Rwanda, 2019; World Bank, 2019a).

While many countries have made recent attempts to reform business regulations, their overall scores have remained relatively stable or improved only gradually (Graph 1). In contrast, Rwanda has managed to successfully

²Rwanda surpasses the average LMIC and African country in the Worldwide Governance Indicators, which have scores for regulatory quality of -0.54 and -0.50, and scores for government effectiveness of -0.55 and -0.83, respectively (Kaufmann & Kraay, 2020). The scale ranges from -2.5 to 2.5 (with a mean of zero), where larger figures refer to improved governance.

³Rwanda's Worldwide Governance Indicator for the control of corruption lies at 0.56, while the average LMIC lies at -0.52, and the African average at -0.66 (Kaufmann & Kraay, 2020).

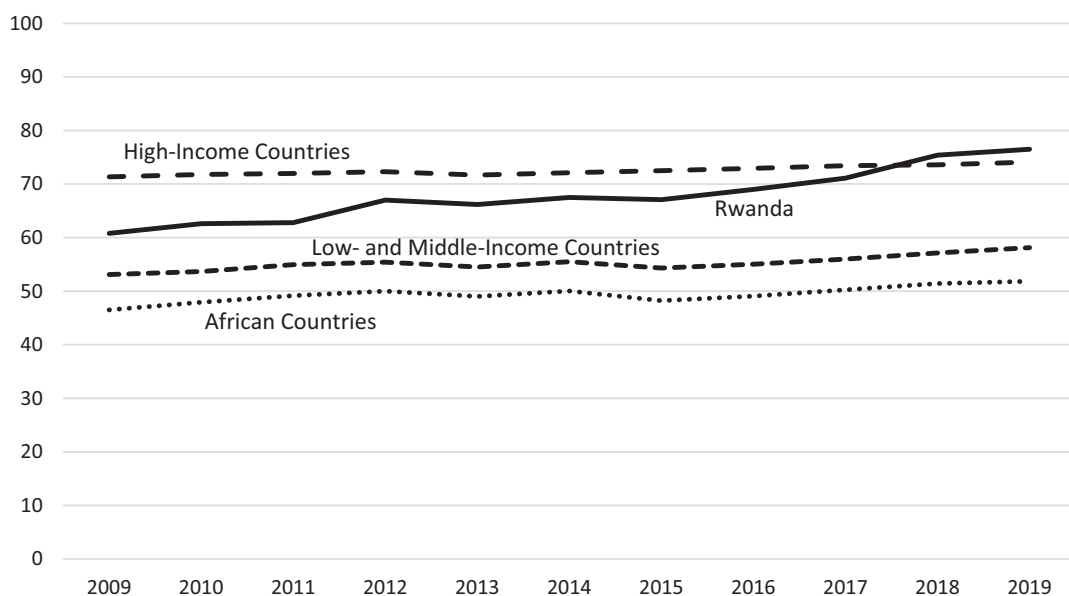
⁴Section 3 provides a more detailed engagement with the criticism of the *Doing Business Indicators*.

TABLE 1 Doing Business Indicators, 2019

Indicator Set	High-Income Countries	Low- and Middle-Income Countries	African Countries	Rwanda
Dealing with Construction	74.40	61.90	58.48	70.60
Paying Taxes	81.73	63.96	57.77	84.60
Trading Across Borders	86.78	65.54	56.38	75.00
Registering Property	72.55	57.30	53.62	93.70
Starting a Business	90.24	81.65	79.83	93.20
Getting Electricity	84.76	62.83	50.43	82.30
Protecting Minority Investors	62.88	46.62	38.83	44.00
Getting Credit	58.98	52.42	45.08	95.00
Enforcing Contracts	64.89	52.68	49.92	69.10
Resolving Insolvency	63.60	37.24	31.39	57.20
Overall Ease of Doing Business	74.10	58.13	51.85	76.50

Note: Scores range from 0 to 100 and refer to distance to frontier, that is, the distance to the best performing country in each category. A higher distance to frontier score shows absolute better ease of doing business. We use the World Bank's definition of income groups.

Source: World Bank (2019b).



GRAPH 1 Doing Business Indicators, Average Scores, 2009-2019

Source: World Bank (2019b). Note: see Table 1.

improve its overall ease of doing business, having even surpassed the groups of LMIC and African countries before 2010, and the average high-income country by 2018.

While Rwanda does not perform as well in the Global Competitiveness Report as it does in the Doing Business Indicators, it still outpaces the average African and LMIC in every pillar of competitiveness, except for skills and market size, and has made sizeable improvements in its ICT adoption and innovation capability (World Economic

Forum, 2019).⁵ Rwanda even ranked within the top 20 for its business and labour-market regulations in 2017 (Gwartney et al., 2019).

In 2008, the GoR followed Asian examples of development boards and set up the Rwanda Development Board by merging eight existing government agencies to promote business-oriented thinking and the founding of SMEs. The Board's main task is to streamline and facilitate investment in the country and to increase the private sector share of the gross domestic product (GDP) (Akamanzi et al., 2017). This is done by centralizing the implementation and evaluation of business regulations in accordance with several ministries and, inter alia, by connecting the government and larger companies in private-public partnerships (PPPs). Through acting as a mediator between foreign investors and local bureaucratic barriers, the Rwandan government has become an active global player. It was able to build successful PPPs with VISA, Marriott Dubai and several international universities for joint projects in Rwanda's private sector and developed the Kigali Master Plan for urbanization together with the US firm Oz Architects and the Singaporean firm Surbana Jurong (Crisafully & Redmond, 2012; Goodfellow, 2014). Hence, the Rwanda Development Board was able to implement a mixture of domestically adapted international best-practice approaches and home-grown solutions specific to Rwanda's culture, traditions and economic challenges (Republic of Rwanda, 2010, 2019).

Despite the government's continuous efforts to attract foreign investment in ICT and to emphasize the creation and building of SMEs in the industrial and service sector, Rwanda's narrow export base remains heavily reliant on its agricultural sector and the colonial cash crops of coffee and tea. In 2020, 47.6% of Rwanda's working-age population was involved in either subsistence or market-oriented agriculture (NISR, 2021), not including agricultural work in the informal economy.⁶ Thus, regulatory reforms must take into consideration that Rwanda's economy cannot develop solely relying on manufacturing, ICT, and (other) services.

Rwanda's private sector remains small and limited, and its capacity underused due to a lack of sufficient working capital and its dependence on the import of raw materials (Republic of Rwanda, 2017). The government cannot pick winners but must home grow and foster promising sectors by means of benevolent regulatory reforms. Therefore, Rwanda reformed all the fields relevant to a good business climate, including new laws for insolvency, investment, financial inclusion, land tenure and privatization (FinScope, 2020; Republic of Rwanda, 2019; World Bank, n.d.-b). For example, the GoR implemented the Small and Medium Enterprises Development Policy and the Entrepreneur Development Strategy to account for the country's overwhelmingly large share of SMEs (99.3%) within the private sector (Behuria, 2019; Himbara, 2020; Republic of Rwanda, 2010; Rwanda Development Board, 2018). The regulations aimed to facilitate the access to business development services, finance, as well as local, regional, and international markets to promote the growth and productivity of smaller companies. As a side effect, the tax base was to increase, and more off-farm employment capabilities were created (Republic of Rwanda, 2010). However, smaller businesses in Rwanda still lack market power and have limited engagement in global value chains (Frazer & van Biesebroeck, 2019). Although 800,000 Rwandans owned a business and employed 800,000 additional workers in 2019, only 53% of these businesses have been formally registered (FinScope, 2020). Whereas the formal sector only has limited access to the international market, the informal economy lacks any expansion of market power.

The government is aware of these shortcomings and aims to reduce the size of the informal economy by integrating informal financial mechanisms into the formal financial sector, for example through savings co-operatives (Republic of Rwanda, 2019). The GoR aims to provide formal financial services to 100% of Rwandan adults by 2024 and to starkly reduce the costs of financial transactions (FinScope, 2020). Yet, Rwanda's banking system remains mostly privatized, consisting of a few large banks and many semi-transparent government-led community

⁵Rwanda ranks overall 38th out of 191 countries with available data in the Doing Business Indicators, while it ranks only 100th out of 141 countries in the *Global competitiveness report* (World Economic Forum, 2019). Rankings have been paused for the *Global competitiveness report 2020*.

⁶According to the World Bank (2013), roughly 80% of total employment is dependent on agriculture.

microfinance institutions (IMF, 2012). Although schemes like the *ubudehe*⁷ community credit ought to increase access to financial services in rural areas (Local Administrative Entities Development Agency, 2018), many companies list access to finance as the biggest obstacle in Rwanda's business environment (World Bank, 2020).

3 | IMPACT OF BUSINESS REFORMS

The GoR puts great value on its efforts to foster economic development and to constantly reform its business environment within its long-term development strategy. As the Doing Business Indicators in Table 1 display Rwanda's best performances in starting a business (93.2), getting credit (95.0), and registering property (93.7), it can be assumed that reforms in these fields have been implemented most successfully. However, the Doing Business Indicators have faced criticism for their statistical methodology, the omission of factors, such as the level of corruption or gender equality, and the lack of a causal relationship between the indicators and the actual growth of economies (Holden & Pekmezovic, 2020; Veit & Streege, 2012). We can control the level of corruption to some extent by also considering the Worldwide Governance Indicators. However, the Rwandan perception of corruption generally only entails bribery, while other forms of corruption are not considered as such (de Dieu Basabose, 2019). As the level of corruption is often measured by opinion-based surveys, the validity of the GoR's performance in this regard is questionable. Moreover, President Kagame and the ruling Rwandan Patriotic Front (RPF) are frequently criticized for their authoritarian conduct, their inability to provide citizens with a voice or to offer accountability, and have been accused of overstating positive developments and window dressing (Booth & Goloba-Mutebi, 2014; Thomson, 2018).⁸ Therefore, the true success of implementing reforms and their positive impact on Rwanda's economy as measured by indicators is worthy of closer investigation.

The year 2009 can be seen as a watershed for Rwanda as a reformer for the ease of starting and closing a business. Among others, the GoR implemented new insolvency and mortgage laws, as well as the Company Act which brought to life the one-stop shop for business registrations (Savini Zangrandi & Mogollon, 2015). This reform cut the requirements for opening a business from eight to six procedures, from 14 to seven days, and the costs from 108.9% of GDP per capita to 10.1% (World Bank, n.d.-a).⁹ The impact has been quite impressive, as business density increased significantly from 2008 to 2012 (Graph 2).

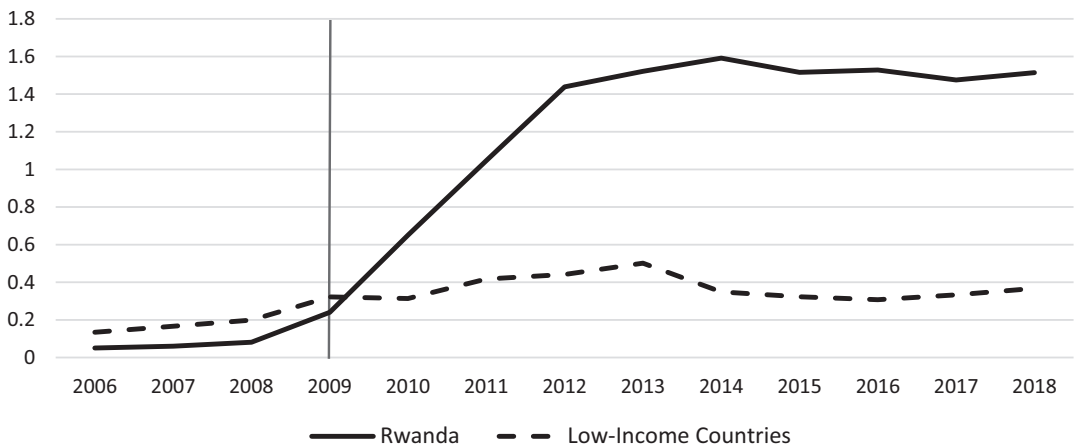
Two studies have examined the effects of facilitating business registration in a more formal analysis. Gathani et al. (2013) examine the direct impact of the one-stop shop on the economy between 2009 and 2013 by using a synthetic as well as a proximity control, and estimate that an increase of 186% in new registrations in a single year (2009) can be directly linked to the reform. In the same manner, Savini Zangrandi and Mogollon (2015) find that company registrations grew at a compound rate of 51% between 2008 and 2012, with more than 80% of new companies becoming active within the first year after registration. They further find that the newly registered companies accounted for 24% of the increase in tax declarations in 2012, contributing positively to the state budget. Between 2009 and 2018, Rwanda realized 47 reforms that affected the lifecycle of a company (Solf et al., 2020). This indicates that the reforms brought the entrepreneurial mindset of Rwandans into real-life economic entities and successfully created incentives to open businesses by relieving them of obstructive regulations.

Although Veit and Streege (2012) are critical of the high rankings in the Doing Business Indicators regarding the perception of reforms "on the ground" (p. 105), their own survey confirms that improvements in the ease of starting a business have indeed been felt within the population. Still, the value of 93.20 in the Doing Business

⁷The *ubudehe* credit scheme is a pro-poor growth mechanism in which financial accessibility is provided for clients who would not be eligible for formal credit. In the *ubudehe* scheme, clients sign a contract with the community and will be informed of their obligations to repay so that the next beneficiary can take a loan from cumulative reimbursed amounts (Local Administrative Entities Development Agency, 2018).

⁸Rwanda's score for voice and accountability in the Worldwide Governance Indicators amounts to -1.13 (Kaufmann & Kraay, 2020).

⁹Due to additional reforms, these figures have been cut to five procedures, four days and 0%, respectively (World Bank, n.d.-a).



GRAPH 2 Business Density in Rwanda, 2006-2018

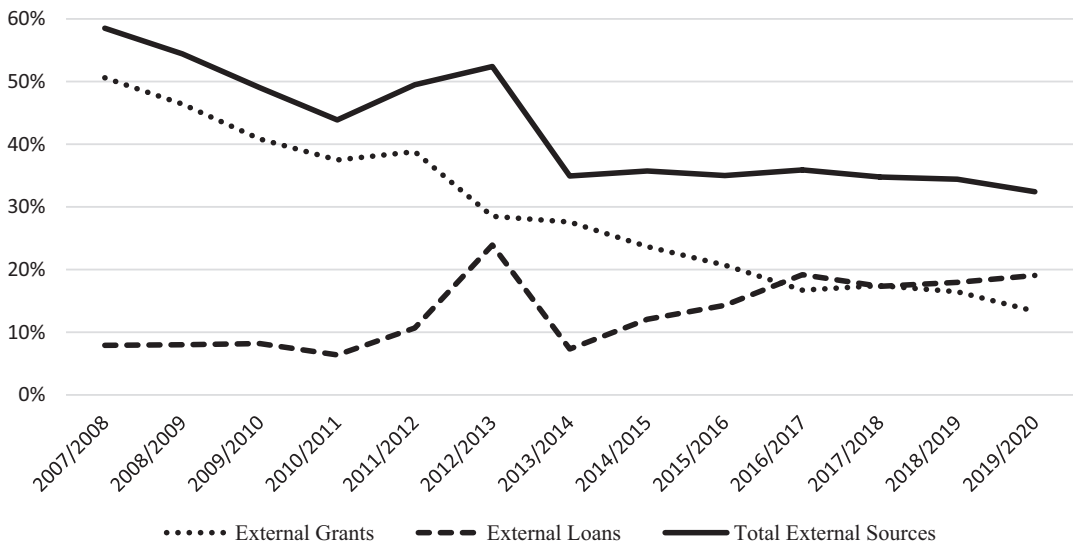
Note: Business density is defined as new business registrations per 1,000 people aged 15-64. The group of low-income countries is composed according to World Bank definitions. Source: World Bank (2019c) and own calculations.

Indicators for the low costs and short time to start a business might be exaggerated. Rather than four days to open a business, the total engagement period until a business can fully operate can add up to three to four months due to a large bureaucratic burden in the attainment of tax registration numbers and the completion of bank account openings (Healy Consultants Group, 2021). Furthermore, half of the businesses that registered from 2008 to 2012 have filed their taxes in Kigali, indicating that there is bias towards the Rwandan capital (Savini Zangrandi & Mogollon, 2015).

This bias also has an impact on the validity of the Doing Business Indicators in general, as the index is solely measured in the capital. While this is the methodology for all countries considered in this index, the scores can be applied best to countries with lower levels of inequality between urban and rural areas. Rwanda, however, displayed the largest degree of inequality in East Africa in 2016, and provides people in Kigali with better infrastructure and easier access to healthcare, education, and finances than their rural counterparts (FinScope, 2020; Murenzi, 2018; Republic of Rwanda, 2019; Thomson, 2018). It is therefore plausible that Rwanda's national average in the ease of doing business is considerably lower than officially presented. This could imply that Rwanda's approach to regulating businesses might be too narrow as it focuses on urban areas, and more importantly, tries to accommodate the respective measurement methods of the indicators. Hence, the largest dips in the Doing Business Indicators for Rwanda between 2003 and 2019 can be found in those years in which alterations to the respective measurements of indicators were made (World Bank, 2019b).¹⁰ Similarly, the *Global Competitiveness Report* altered its measurements of economic competitiveness according to the fourth industrial revolution from 2018 onwards. This translated Rwanda's 58th ranking of 2017 into the 107th ranking, showing that Rwanda's performance was too narrowly focused on fulfilling specific measurements. This was especially noticeable in the performance in labour and financial regulations, as well as in the country's innovation capability (World Economic Forum, 2017, 2018). The progress in Rwanda should consequently not be regarded as generally legitimate, but rather as limited to precise measurements and definitions.

Regardless, Rwanda's good performance in global rankings is still of great importance, as it can be used to secure more foreign investment and aid. Rwanda has been funded externally between 30% and 40% ever since the fiscal year 2013/2014 (Graph 3) and is unable to finance its budget, and thus its regulatory reforms, on its own. However,

¹⁰Rwanda's scores dropped by 25.3 points for protecting minority investors in 2014, by 13.1 points for trading across borders in 2015, by 16.1 points for getting electricity in 2015, and by 10.9 points for enforcing contracts in 2016 (World Bank, 2019b).



GRAPH 3 External Financing of Rwanda's Government Budget

Note: The total external sources, as well as the external grants and external loans are depicted in percent of total government budget of the respective fiscal year. The data is based upon the published enacted and, if available, adjusted budgets. Sources: Ministry of Finance and Economic Planning (2020); Collaborative Africa Budget Reform Initiative (2021).

President Kagame puts great value on becoming independent of official development assistance (ODA), which can be seen in Rwanda's substantial decrease in the external financing from nearly 60% in 2007/2008 to 32.5% in 2019/2020. Moreover, Rwanda's persistence in seeking to become a financially independent state is mirrored in the composition of the external funding: Whereas 86% of external financing in 2013/2014 was made up of grants (more than half of the total government budget), only 41% of external financing was acquired in this manner in 2019/2020. Simultaneously, the share of the government's external loans budget has been increasing over the last few years.

Hence, the Rwanda Development Board was initiated to not only facilitate Rwanda's business environment but also to attract foreign direct investment. Rwanda and Mauritius are the only African countries in the top 50 of the Doing Business Indicators 2020, yet Rwanda still draws the least amount of foreign investment among its East African peers (Himbara, 2020). A possible factor behind this is the government's inconsistency in the application of business regulations and laws, if they benefit companies which diverge from RPF guidelines or express political criticism. While the GoR affably integrates large government-friendly companies into policy design processes, it has no qualms about unlawfully repossessing companies, regardless of general efforts to increase privatization. One of the most prominent examples for this was the seizing and selling of the Union Trade Center and the Nshili Kivu Tea Company, under the pretence that the former owner had abandoned his businesses by residing abroad (Mann & Berry, 2016).

Similarly, the expropriation of land becomes evident in urban areas, especially in Kigali (Goodfellow, 2014). As land is scarce and an important store of wealth, i.e. as collateral for loans, it is crucial to successfully regulate land ownership, especially considering the return of many refugees after the genocide. Rwanda implemented several reforms to make registering property easier and cheaper by improving land-dispute resolution mechanisms, creating online services and making the land administration system more transparent (World Bank, n.d.-b). These reforms led to a very good ranking in the Doing Business Indicators (93.7). However, the Expropriation Law of 2007 and the Organic Land Law of 2005 ensured that the state retains enough power to expropriate land in the public interest (Goodfellow, 2014). Since Kigali is not only Rwanda's capital but also its political, economic, and social hub, public interest can be interpreted very broadly, for example, for international for-profit ventures or luxury housing development. This shows that the GoR is able to bend "state laws, policies and regulations at free will, without any counterbalancing checks" (Himbara, 2020,

p. 41), which increases uncertainty within the business environment. Rwanda's performance in global indices is hence rendered even more essential for the willingness of potential investors and donors to contribute. In order to guarantee a good ranking, it seems as if the GoR designs its policies to fit measurement methods rather than to tackle actual hindrances to the country's business, political, and social environment.

In general, the GoR's domestic adaptations of best-practice reforms are designed to be successful in theory, but some fail to achieve the desired effects on those who should benefit most. For example, the co-operative model which was designed to shift informal work into the formal sector to allow for better access to credit, public services and property rights, prohibits individuals from working in market vending or taxi driving other than as members of a co-operative. However, if individuals cannot pay the mandatory fee and collateral to join, they are rendered unable to generate income without fear of punishment and fines (Honeyman, 2016; Mann & Berry, 2016).

In Rwanda's formal economy, various regulations are tailored to the specific needs of large companies, since the second and tertiary sector are dependent on them. In contrast, regulations for SMEs tend to miss the target. Booth and Golooba-Mutebi (2012), for example, find that regulations for smallholder agriculture have not been given a consistent focus, despite the large share of employees in this sector. As a result, larger companies are disproportionately favoured and given preferential treatment even though they are already succeeding in the market. This distorts Rwanda's universal business capacity, as its private market is dominated by government-owned or RPF-sympathetic companies which systematically outperform the smaller firms (Mann & Berry, 2016).

4 | DRIVERS OF CHANGE

Despite some doubts about the extent of the reforms' positive impact on the economy, Rwanda's progress in its regulatory conduct is noteworthy, especially considering its troubled past and its status as a low-income country. How can this drive for reform be explained? We focus on why Rwanda stands out in its regulatory governance and identify four distinct, yet coherent, drivers of change that account for Rwanda's current political, social, and, especially, economic situation. These drivers of change can seamlessly be integrated into the framework of the developmental state theory. The academic discourse has often examined Rwanda's post-genocide development within this context (Booth & Golooba-Mutebi, 2012; Hasselskog, 2018; Honeyman, 2016; Goodfellow, 2017; Nwapi & Andrews, 2017) to explain Rwanda's efforts in "pursuing national development with a clearly defined ideological and institutional commitment" (Nwapi & Andrews, 2017, p. 227). In addition to the developmental state framework, we apply Englebert's (2000) notions of pre-colonial legitimacy and argue that early institutions and traditions also have an impact on Rwanda's contemporary institutions and, thus, on its current regulatory quality.¹¹ All the Rwandan drivers of change are either directly based on this continuity or at least refer to the country's singular history.

4.1 | Political legitimacy through economic success

Already in the pre-colonial era, Rwanda displayed a close relationship between authority and economic success. Back then, social and political standing were to a large extent determined by the size of one's cattle herd. Pre-colonial *mwami* (kings) derived their power from military control and their superiority in cattle-farming. Early

¹¹Englebert (2000) postulates that the extent to which post-colonial state institutions conflict with pre-existing ones largely accounts for cross-country development differences in African countries, and finds that the more legitimate the state, the greater the quality of its governance. Legitimacy is defined vertically, referring to the right to rule, and horizontally, entailing agreement about the definition of the community to be ruled.

armies were given cattle and land for usufruct, and as a reward, to encourage the expansion of the Nyiginya kingdom (Rennie, 1972).¹²

This embeddedness of the government within the economy continued throughout the colonial and post-colonial times and played a critical role in starting capital accumulation during the early stages of rebuilding Rwanda's economy after the genocide. The RPF was able to benefit from monopoly rents and to firmly implant itself within the economy, making a split or even alleviation impossible. The strong hand of politics targets the development of the economy directly, making growth the overriding priority of the RPF. Today, three government firms dominate the private market: Horizon Group Limited, operated by the Rwandan Defence Forces; Rwanda Investment Group, a public-private investment consortium; and, foremost, the RPF's own Crystal Ventures Limited, which holds minority and majority stakes in several companies and joint ventures (Booth & Golooba-Mutebi, 2012). The firm invests in fields that show potential for socioeconomic spillovers and are compliant with *Vision 2050*. The government thus acts as initiator and risk-taker at the same time in order to introduce private sector possibilities, while generating further monopoly rents. Most infrastructural development projects are realized by party- or military-owned enterprises, and are thus generating rents for the RPF (Behuria & Goodfellow, 2018; Booth & Golooba-Mutebi, 2012; Himbara, 2020). Even if the GoR also uses open deals in sub-sectors, which are often won by Asian companies, government-led companies are given preferential treatment in public procurement processes. As this ties the provision of public goods directly to economic rents for the ruling elite, socioeconomic improvement for the masses is guaranteed by the profit-maximizing RPF. Even if centralized rent management is not unusual within the developmental state theory, these growth-enhancing rents can become growth-retarding if the relationship between the bureaucracy and the economy is altered, or even if the composition of the political environment is changed (Khan, 2000). The continuation of the RPF's conduct is thus vital for the positive development of Rwanda's economy, and vice versa.

The close connection between the RPF and the economy also explains why corruption is severely punished in Rwanda. Since corruption is harmful to the economic prosperity of a country, rent-seeking by Rwandan elites would undermine their own profits. Dreher and Gassebner (2013) find in their analysis that an increase in the level of corruption leads to a significant reduction in entrepreneurship for the average country in which the costs of starting a business amount to zero. As the Doing Business Indicators depicts the costs of starting a business in Rwanda at zero, higher levels of corruption would lead to a hinderance in the ease of doing business.

As economic success is not only used to financially strengthen the elite but also needed to secure their position of power, it is of the utmost priority in Rwanda to generate growth. The GoR thus focuses on the creation of a benevolent business environment and tries to avoid high levels of corruption, which played a role in the failing economy under the previous leaderships (Desrosiers & Thomson, 2011). Still, the government's conduct remains more authoritarian than democratic, which could result in instability and unrest. As Rwanda's past has shown that there is a capability for public dissatisfaction to turn into coup d'états and deadly violence, it is of even greater importance to appease the masses and to legitimize the leadership via various economic channels. Thus, the GoR not only benefits from economic development through higher rents, but also passes parts of these financial gains to the people through "wealth-sharing mechanisms" (Mann & Berry, 2016, p. 128). Rwandan peasant farmers profit from a free healthcare system and free primary education, from pro-poor-growth policies, and from spillovers stemming from improvements in infrastructure. It thereby gives the impression of being a more inclusive and democratic government, even if it mainly accommodates economic winners.

4.2 | Managerial leadership

Where Rwanda's economy is characterized by government interventions and state-owned enterprises, the state itself is governed like a company (Mann & Berry, 2016). The ruling RPF and its long-time leader Paul Kagame see

¹²Several pre-colonial clans settled in the geographical area that is today's Rwanda. The Nyiginya clan emerged as the dynastic line of Rwanda, creating the Nyiginya kingdom from the 17th century onwards (Reyntjens, 2018).

economic development as a way to fight ethnic tensions and achieve national unity as the “traumatic divisions of the past are healed in the melting pot of commercial activity and burgeoning employment” (Kagame, 2007, p. 4). The GoR attaches great importance to the encouragement of entrepreneurial mindsets on the part of its citizens to become creative, self-reliant, and economically driven. The GoR seeks to portray itself as a role model in this regard without relinquishing its regulatory power in the market (Honeyman, 2016). While President Kagame has built up personal relations with international donors and investors and markets the Rwanda “brand” to reform the private sector (Friedman, 2012), government-led companies invest heavily in sectors which are seen to be developing too slowly. The GoR’s determination to transform the agricultural-based economy into a modern business environment for high-level investment is governed by Kagame’s managerial leadership style, and embodies his stance towards development and execution. The party’s approach to development strongly refers back to its origin as a guerrilla army which infiltrated Rwanda during the 1990s to initially overthrow the regime, and to then end the genocide (Uvin, 1999). True to its military background, policies are implemented centrally and hierarchically. The government thus manages to integrate itself within the economy, to express an exceptionally strong approach to state ownership, and to ensure government effectiveness by swift execution of policies and regulations regarding *Vision 2050* (Keijzer et al., 2020).

Although Rwanda’s approach within the scope of the developmental state theory has been described as “post-developmental” (Honeyman, 2016) and “neo-developmental” (Goodfellow, 2017), we find that the GoR’s conduct matches the “developmental patrimonialism” approach identified by Booth and Golooba-Mutebi (2012).¹³ The term describes a concept in which “the ruling elite acquires and takes an interest in, and a capability for, managing economic rents in a centralized way with a view to enhance their own and others’ incomes in the long run rather than maximising them in the short run” (Booth & Golooba-Mutebi, 2012, p. 381). This implies that ruling elites face internal pressure to not only generate growth but also continuous growth. Due to the strong interconnectedness of the government and the economy, this increases the share of rent-seeking and improves the living conditions and the ability to do business of the general population at the same time, without undermining the GoR’s legitimacy. Yet, Rwanda’s fast-paced transformation comes at the cost of Kagame’s rigour and oppression. Matfess (2015) develops Booth and Golooba-Mutebi’s definition of Rwanda’s development approach into the concept of “developmental authoritarianism.” This features legal restrictions on association, speech, and identity, alongside government interventions into the economy to promote extensive development, as well as party-organized mobilization of the population for developmental efforts. Although President Kagame has been widely praised for the liberalization of Rwanda’s economy, these characteristics render him more like a benevolent dictator than a good democratic ruler.

4.3 | Central pre-colonial institutional framework

Government efforts to foster the economy would be in vain if regulations and policies did not reach the general population. In this regard, Rwanda profits from a highly structured state from top to bottom, held together by a network of personal relations and an intensive, well-functioning administration. The strong interconnectedness of the government and the economy is thus possible only because of a centralized state, which has been in place since the early Nyiginya kingdom.

As mentioned above, pre-colonial traditions and institutional structures influence contemporary policies. One component is the degree of pre-colonial political centralization. Gennaioli and Rainer (2007) define politically centralized pre-colonial groups as those with some form of government with large, territorially integrated political entities. Political centralization involves some form of state structure with a political hierarchy. In contrast, fragmented ethnic

¹³Honeyman (2016) identifies Rwanda as combining the developmental approach with notions from free-market neoliberalism, especially in terms of creating entrepreneurial mindsets, while the analysis by Goodfellow (2017) focuses on Rwanda’s investment in economic key sectors and the GoR’s ability to discipline these sectors towards growth.

groups are organized in many small political units with no political integration above village level. Hence, the inheritance of a highly structured, centralized state system favours learning by doing in the national administration, and the quicker growth-enhancing adoption of Western technologies; it benefits linguistic unity and thus a common identity; it supports the development of positive attitudes towards hierarchical regulation, the moral authority of the state, and thus the loyalty of its citizens; and it allows for a profound technological, economic, and social transition to statehood over a longer period of time (Bockstette et al., 2002; Englebert, 2000; Michalopoulos & Papaioannou, 2011; Sylwester, 2008).

Unlike most of its neighbouring countries, Rwanda has a singular history as a state, emerging with the Nyiginya kingdom. The legitimacy of kingly power was based on, and constrained by, spiritual rituals, and military power was centralized to expand and govern the state. As the central court rule was harder to implement on the periphery, rulers relied on their already highly structured state apparatus. They employed a tripartite system of chieftainship with overlapping mandates, who were to execute the *mwami's* orders to rule over Hutu, Tutsi, and Twa alike (Thomson, 2018).¹⁴ This system also ensured that ruling elites could not develop extractive behaviour as they were constrained by their co-chiefs and the king. Due to the lack of natural resources, the extraction of rents was limited to cattle and land within client–patron relationships (Prunier, 1995).

When Germany claimed Rwanda as a colony in 1885, the Nyiginya kingdom was already a highly structured state with a centralized polity and a hierarchical society, which allowed for relatively even distribution of authority and accountability. Germany, and later Belgium, reinforced the state power of local elites and allowed for further expansion of the state and helped to control the last rebellious regions within the kingdom (Prunier, 1995). Although the colonizers altered the political system and intensified political and social inequalities between Tutsi and Hutu, they did not create a new state, but took over sovereignty for a limited period of time (Newbury, 1998). Rwanda can be considered a Tutsi-governed monarchy with Hutu majorities before colonization, and, within the scope of Englebert's (2000) work, a legitimate state, whose existing political structures and, to a lesser extent, its geographical boundaries correspond to the pre-colonial state. Still, the alterations to the executive and legislature, which were implemented by the colonizers and reinforced during the First and Second Republic of Rwanda, made it impossible to completely revert to pre-colonial conduct. Instead, the GoR created modern home-grown solutions to account for the altered economic, political, and social setting after the genocide.

According to Herbst's (2000) explanation of state centralization processes, Rwanda was in a favourable position for state consolidation. Rwanda is among the very small countries where population distribution becomes irrelevant—the territory is so small that the capital of Kigali is close to the majority of the population. Authority can easily be extended to consolidate politics under a state umbrella, and thus be used to uniformly govern the population. Indeed, Gennaioli and Rainer (2007) confirm that the degree of pre-colonial political centralization in Rwanda is high, ranking at 0.982 on a scale of 0 to 1.¹⁵ For a sample of 42 African countries, they find that pre-colonial centralization is positively associated with the provision of public goods in post-colonial times because the accountability of local chiefs was strengthened and state control over local chiefs facilitated. The cross-country finding is valid for contemporary Rwanda. Today, the GoR embeds its power in local politics through an adaptation of the pre-colonial *imihigo* accountability system. In this system, responsible officials at all levels have to enter performance contracts and swear to implement specific development goals as instructed by the government in order to receive funding and assistance (Thomson, 2018). These contracts aim to produce results-oriented performance, monitor results, and curb corruption and rent-seeking.

¹⁴The Chief of Landholdings was responsible for agricultural production and attributing land, the Chief of Men was responsible for the rule of men and the recruitment of fighters for the royal army, and the Chief of Pastures ruled over the grazing lands for cattle (Prunier, 1995).

¹⁵Only Comoros, Lesotho, Swaziland, and Burundi have a more complete centralization, which is measured as the share of a country's indigenous population that belongs to a centralized ethnic group. A group is considered centralized if it has two, three, or four jurisdictional levels above the local community (Gennaioli & Rainer, 2007).

4.4 | Aid effectiveness

Despite its advances in development, Rwanda remains highly dependent on financial and technical resources from donor agencies, with more than 32% of the 2019/2020 government budget financed by external resources (Graph 3). From 2002 until 2019, Rwanda received a total of USD 16.5 billion in ODA (World Bank, n.d.-a). The GoR's drive for improvement, Kagame's well-received style of economic leadership as well as the international "desire for African success stories" (Zorbas, 2011, p. 104) make Rwanda an attractive recipient of aid for business policy and administration. Hence, it received aggregated aid flows of USD 58 million for its business policies and administration, amounting to 0.35% of total aid flows in that period (OECD, 2021).¹⁶

As changes in regulations are not very costly to implement in Rwanda's authoritarian setting (compared to building infrastructure, for instance), it is not only the amount of aid but also, and maybe foremost, the targeted assistance for reforms combined with a co-ordinated aid architecture on the donor side that makes business aid so effective. So far, Rwanda has managed aid flows well by directing them towards productive public investment and public services, thus mitigating the risks of heavy reliance on grant financing and potentially prioritizing the country for future funding (World Bank, 2012). In addition, effective constraints against large-scale corruption guarantee that aid is not extracted by rent-seeking elites.

Aid effectiveness is not only considered to be higher with solid aid management, but also when aid-recipient countries are strongly committed to the policy agenda. Rwanda's ownership of its development programmes is considered to be strong, as the country can exercise increasingly effective leadership despite its high aid dependence. Already in 2005, Rwanda centralized control over its aid policy in the External Finance Unit of the Ministry of Finance and Economic Planning and introduced several mechanisms for improving the harmonization of aid and the alignment of donors with national strategies (Hayman, 2009). These mechanisms ensure that support is evenly distributed and that finances flow efficiently into projects of greatest importance for Rwanda's economy and society without inter-ministerial competition for funds. As Fraser and Whitfield (2008) assess, the country's unusual strong position vis-à-vis donors originates in its complicated relations with its former main donors like France and Belgium after the genocide, and the strategic use of the RPF's authority as having stopped the genocide, which further increases Rwanda's control and accountability of aid-funded activities.

Keijzer et al. (2020) also identify Rwanda's managerial leadership as the main driver of its aid effectiveness and its domestic adaption of development co-operation. Apart from the above-mentioned positive development for regulatory quality through business aid, they also caution that Rwanda's central approach limits policy alternatives, carrying the risk of turning into a "non-democratic approach" which would discourage future funding, especially, as stakeholders have to adhere to RPF guidelines. And it seems as though donors are already showing declining commitment to Rwanda's national development agenda and are resorting to a "bilateralization" of their relations. Rwanda, in turn, does not accommodate the donors but tries to "discipline [its] partners by providing or retaining co-operation benefits" (Keijzer et al., 2020, p. 45).

This behaviour could bring about unwelcome repercussions for Rwanda's business environment. Despite the country's efforts to counterbalance a potential lack of aid by domestic funds, such as the Business Development Fund or the Agaciro Development Fund,¹⁷ Rwanda is still not able to support itself financially.

¹⁶The figures refer to disbursements in constant USD.

¹⁷The Agaciro [dignity] Development Fund is a sovereign wealth fund which aims to reduce Rwanda's dependence on foreign aid and build up savings independent of economic shocks by collecting voluntary contributions from Rwandans at home and abroad (Agaciro Development Fund, 2021).

5 | CONCLUSION

In the recent past, Rwanda's performance in global economic indices has been presented as a pioneering feat for good regulatory quality to other LMICs. We have examined the validity of the published progress in Rwanda's business environment against the backdrop of critiques of the Rwandan government as well as the indices themselves and found that, despite evidence for true progress, Rwanda's development approach is often lacking a broader objective and true commitment to undertake change. Business reforms may have legitimately succeeded in promoting entrepreneurial mindsets and creating incentives to register companies in the formal economy, but other reforms fail to reach the intended target group or exceed the capability of human development. This is due to the fact that many reforms are specifically tailored to the measurements of well-known indices to portray Rwanda as being more developed than it actually is. De facto improvements are thus not as extensive as they seem on paper. In reality, Rwanda's regulatory reforms are rather a mixture of true progress and window dressing.

Furthermore, we analysed how Rwanda was able to implement regulatory reforms despite its troubled and violent past and its less than favourable setting for economic conduct. For this, we have identified four drivers of change that have determined the progress in the country's regulatory governance through their individual, as well as their synergetic occurrence throughout Rwanda's history: (1) the pressure on the government to generate economic growth; (2) the country's leadership; (3) the institutional framework founded in pre-colonial times; and (4) Rwanda's aid effectiveness.

Due to the highly distinctive composition of its drivers of change, replicating Rwandan policies in other national settings is unlikely to succeed. The close interconnectedness of political and economic entities also makes it inefficient to implement integral changes to Rwanda's current system. For example, a departure from the GoR's reliance on large companies, the setting up of many smaller companies, or the cessation of the authoritarian conduct would jeopardize the government's control, and in turn Rwanda's growth path. International best-practice policies should thus be adapted to the unique domestic setting to bring about positive development and to counterbalance future challenges that are likely to impede further development or destroy the progress that has already been made. In order to achieve comprehensive growth, the government should credibly commit to its own policies and developmental approaches, independent of the measurements and indicators. In this regard, reforms should continuously be evaluated to determine their quality and to determine whether regulatory efforts are worthwhile. In addition, Rwanda should continue its progress in private sector transformation, but should pay heed to the fact that SMEs are forced out of development-critical sectors because of the domination of government-related companies. This directly contradicts the government's efforts to promote entrepreneurship.

DATA AVAILABILITY STATEMENT

Data that support the findings of this study were derived from the following resources available in the public domain and detailed in the Reference list: Collaborative Africa Budget Reform Initiative (2021); Ministry of Finance and Economic Planning (2020); World Bank (2019b) and World Bank (2019c).

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