

Original Article

Rwanda's Dependency on Foreign Aid and How it Affects the GDP: A Critical Analysis of Rwanda's Future Economy

Dheer Chawla

Scottish High International School, Gurugram, Haryana, India

Received: 25 April 2023

Revised: 01 June 2023

Accepted: 17 June 2023

Published: 30 June 2023

Abstract - This paper examines the impact of foreign aid on Rwanda's economic growth and resource efficiency. Despite being aid-dependent, Rwanda has made significant development progress. The study focuses on political alliances, policy environment, and determinants of foreign aid. It highlights Rwanda's transition from agriculture to a diversified economy, emphasizing tourism, manufacturing, and services. Rwanda has experienced economic changes since the early 1990s, recovering from the 1994 genocide. Prioritizing tourism, ICT, and manufacturing led to substantial GDP growth and reduced reliance on agriculture. Exports, including coffee, tea, minerals, and tourism services, flourished. Foreign direct investment (FDI) arrived in manufacturing, infrastructure, services, agriculture, and ICT. Challenges remain, including limited financing access, infrastructure constraints, and high transport costs. Continued support is crucial for sectors like manufacturing, infrastructure, and agribusiness. Gender equality and women's empowerment are vital in entrepreneurship, agriculture, education, and political participation. The study examines Rwanda's tax regime for foreign companies, establishing a fair and transparent business environment. It provides an overview of value-added tax, corporate income tax, capital gains tax, and withholding tax applicable to foreign entities. In conclusion, this paper sheds light on Rwanda's development journey, emphasizing the complex relationship between foreign aid, economic growth, and diversification. It underscores the need to reduce aid dependency, foster sustainable growth, address infrastructure and financing challenges, and ensure gender equality for Rwanda's long-term development.

Keywords - Economic growth, Export, Foreign aid, GDP, Rwanda.

1. Introduction

The debate surrounding whether foreign aid enhances economic growth and resource efficiency has persisted, with researchers and policymakers yet to reach a consensus [26]. Despite numerous studies, limited evidence supports a significant positive impact of aid on the long-term growth of developing nations. Furthermore, previous findings indicating aid's effectiveness under favorable growth-oriented policies have been challenged when considering expanded data and additional variables [26].

Colonial history and political alliances serve as the primary factors determining the distribution of foreign aid. Typically, aid allocation is driven by political and strategic considerations. Donor countries like Nordic nations respond more to appropriate incentives such as income levels, sound institutions, and openness in recipient countries. Conversely, countries like France provide aid to former colonies based on political alliances without considering factors such as poverty levels or politico-economic regimes. On the other hand, the United States aid policy is heavily influenced by its interests in the Middle East [7].

Rwanda has exhibited remarkable political stability and possesses a relatively strong economy, despite being one of the smallest countries globally in terms of land area. The country has a total population of roughly 13.2 million (2022) residing in 26,338 square kilometres, resulting in high population density compared to other African nations. With a GNI per capita of USD 820 (2019), Rwanda falls into the low-income category. Since 1994, Rwanda has achieved political stability and peace, although it remains vulnerable to security and instability spillovers from the Great Lakes region [4].

The Rwandan economy is primarily driven by the services sector (including tourism and MICE exports), the industrial sector (marked by notable advancements in mining production, infrastructure, and operational industrial parks that boost exports), and the agriculture sector (with improvements in land and agricultural efficiency and a shift of labor toward higher-value sectors). Rwanda aims to double the value of its tourism sector to USD 800 million, ensure universal literacy among youth, double agricultural productivity, and create around 1.5 million jobs by 2024 [9]. Presently, agriculture contributes 29% to the country's GDP and employs 66.5% of the working population. However,



Rwanda's economic development is hindered by structural characteristics such as its small size, landlocked position, and low levels of human capital. Although private firms in Rwanda are growing, they have not yet reached a stage where they can generate a substantial number of jobs and drive structural transformation [27].

Despite being one of the most poverty-stricken and aid-dependent nations globally, Rwanda has achieved significant development progress since 2006. Its development strategy has stimulated economic growth, reduced aid dependency, and ensured that the benefits of economic progress reach people experiencing poverty. Nevertheless, Rwanda continues to rank as the fifth most aid-dependent country globally and is expected to remain at this ranking in the medium term.

High poverty levels and economic disparities persist, posing challenges to poverty reduction and the provision of decent employment opportunities. Despite strong growth in terms of economics, the tax base has remained limited, with just 11% of enterprises officially registered with the RRA (Rwanda Revenue Authority) and just 25% of workers engaged in non-agricultural work [2].

However, Rwanda is determined to transition from an aid-dependent economy and aims to reduce aid dependency to less than 50% of its current value by 2050 [10].

2. Change in GDP Over the Years

2.1. History

It is worth noting that Rwanda's economy has undergone significant changes in the last few decades.

In the early 1990s, Rwanda's economy was primarily based on agriculture, which employed the vast majority of the population. However, the country's economy was severely impacted by the 1994 genocide, which resulted in the deaths of an estimated 800,000 people and the displacement of millions more [25].

Since then, Rwanda has made significant strides in rebuilding its economy, with a particular focus on promoting economic growth and reducing poverty. The country has invested in infrastructure and has prioritized sectors such as tourism, ICT, and manufacturing. These efforts have helped diversify the country's economy, reducing its agricultural dependence [5].

Overall, while reliable data on Rwanda's GDP is only available for the last few decades, it is clear that the country has experienced notable economic changes in the last few years, with a focus on promoting growth and reducing poverty. [29]

Table 2.1 Rwanda's GDP over the years

Year	GDP (Billions of US Dollars)
2016	7.4
2017	8.4
2018	9.0
2019	10.6
2020	9.1
2021	9.8

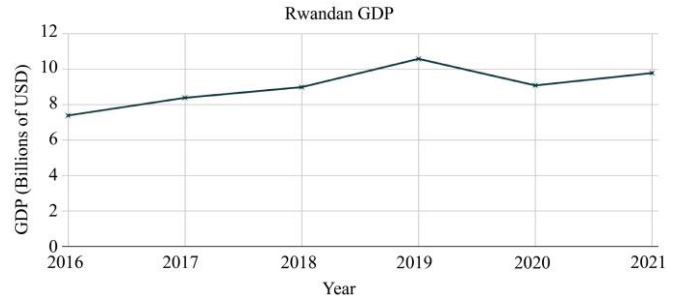


Fig 2.1. Rwanda's GDP over the years

As can be seen, Rwanda's GDP has increased from \$7.4 billion in 2016 to an estimated \$9.8 billion in 2021, although the COVID-19 pandemic caused a slight decrease in 2020. Rwanda's economy has shown resilience and steady growth in recent years.

2.2. Dependency over the years: Agriculture, Food, Tourism

As for the variation of Rwanda's economy with time, it has undergone significant changes over the years, with regard to the country's dependency on agriculture, food, and tourism playing a key role in its economic development.

In the early years of Rwanda's independence, agriculture was the predominant sector of the economy, providing employment to a vast majority of the population and accounting for a noteworthy share of the country's GDP. However, this reliance on agriculture caused the economy to become vulnerable to external shocks such as weather patterns and massive fluctuations in commodity prices. Despite this, the sector remained an important part of the country's economic development.

In the 1990s, Rwanda's economy was still heavily reliant on agriculture, with the sector employing the heavy majority of the population and correlating for a prominent share of the country's GDP. However, the 1994 genocide had a massive impact on Rwanda's overall economy, particularly the agricultural sector[3].

In the years following the genocide, the Rwandan government made various efforts to rebuild the country's economy and reduce its agricultural dependence. The government decided to prioritize economic growth and poverty reduction, making significant investments in

infrastructure and promoting sectors such as tourism, ICT, and manufacturing.

Tourism has become an increasingly important part of Rwanda's economy in recent years, with the country's stunning natural beauty and rich cultural heritage attracting tourists worldwide. The country's tourism industry has grown rapidly over the years, with the number of visitors increasing from just over 300,000 in 2006 to over 1.7 million in 2019 [3]. According to the Rwanda Development Board, tourism generated \$498 million in revenue in 2019, making it the country's second-largest source of foreign exchange earnings. This growth has been fueled by the country's efforts to develop its tourism infrastructure and promote the sector as a key driver of economic development.

In addition to agriculture and tourism, food has also played a critical role in Rwanda's economic development. The country has a rich culinary heritage, with traditional dishes such as ugali, beans, and vegetables forming the cornerstone of the Rwandan diet. In recent years, the government has made efforts to promote Rwandan cuisine both domestically and internationally, with initiatives such as the Rwanda National Agriculture Export Development Board (NAEB) helping to promote the country's food exports [13].

While Rwanda's economy has expanded in recent years, agriculture remains a key part of the country's economic development. The sector continues to employ the majority of the Rwandan population and contributes to a significant share of the country's GDP [6]. The Rwandan government is making extensive efforts to modernize the agricultural sector, with a particular focus on increasing productivity, improving infrastructure, and promoting commercial farming. These efforts have helped to reduce the country's reliance on agriculture and promote economic diversification, although the sector still plays a crucial role in the country's economy.

3. Rwanda's Export Economy

3.1. Introduction

Rwanda's economy has undergone a significant transformation in recent years, wherein the country has transitioned from a primarily agricultural-based economy to a more diverse one that includes a strong focus on exports.

3.2. Historical Overview

Rwanda's export sector has undergone tremendous growth over the past few decades. According to the World Bank, Rwanda's total exports increased from just \$60 million in 1995, right after the genocide, to \$2.11 billion in 2021, alluding to a growth rate of over 3500% [30].

This growth has been driven by a number of factors, including the government's focus on promoting exports and diversifying the economy, as well as improvements in infrastructure, trade policies, and business climate.

3.3. Main Exports

Rwanda's main exports include coffee, tea, and minerals [21]. Coffee and tea are Rwanda's largest exports, accounting for approximately 60% of total exports [20]. Rwanda's coffee is highly regarded for its quality and is primarily sold to European and American markets. Tea is also an important export, with Rwanda being the 19th largest tea producer in the world [15].

In addition to coffee and tea, Rwanda has also seen growth in its mineral exports, particularly tin, tungsten, and tantalum. These minerals are used in various industries, including electronics and aerospace. According to the Rwanda Development Board, the country's mineral exports increased from \$346.6 million in 2018 to \$733 million in 2020 [14].

3.4. Trade Partners

Rwanda's main trade partners include the DRC (Democratic Republic of Congo), the United Arab Emirates and Thailand. According to the Observatory of Economic Complexity, the Democratic Republic of Congo is Rwanda's largest export market, accounting for trade worth \$587 Million in 2021. The United Arab Emirates is the second-largest market, accounting for trade worth \$438 Million in exports, followed by Thailand at \$78.8 Million [18].

3.5. Challenges and Opportunities

Despite its success in growing its export sector, Rwanda faces a number of challenges that could impact its future prospects. These include a lack of access to financing, limited infrastructure, and high transport costs. According to a report by the International Trade Centre, these challenges have led to a high cost of doing business in Rwanda, making it difficult for businesses to compete internationally.

However, Rwanda also has a number of opportunities that could help to overcome these challenges and drive further growth in its export sector. These include its strategic location in the heart of Africa, its membership in the East African Community, and its strong commitment to improving its business environment.

4. Women in Economy

Women play a significant role in the Rwandan economy and have made remarkable progress over the past few years. The government of Rwanda has implemented several policies and initiatives to promote gender equality and women's empowerment in various sectors. Here are some key aspects of women's participation in the Rwandan economy:

4.1. Entrepreneurship and Business

Women have shown great entrepreneurial spirit in Rwanda and have actively participated in the business sector. As of 2020, women-owned around 42% of registered businesses in Rwanda [16].

4.2. Agriculture

Agriculture is a vital sector in Rwanda, and women play a crucial role in this domain. Women make up about 70% of the agricultural workforce in Rwanda [8].

4.3. Education and Skills Development

Rwanda has made significant strides in promoting girls' education, leading to an increase in female literacy rates. The gross enrollment rate for girls in primary education was 141% in 2019 [28].

4.4. Leadership and Political Participation

Rwanda is renowned for its high representation of women in politics. The country has one of the highest proportions of female parliamentarians globally, with female participation summing to 61.3% of seats in the Chamber of Deputies as of June 2023 [12].

4.5. Legal Framework

Rwanda has enacted legislation to promote gender equality and protect women's rights. The Gender Equality and Women's Empowerment Policy was adopted in 2008 to promote gender equality in Rwanda [1].

Despite these advancements, challenges persist in achieving full gender equality in the Rwandan economy. Some barriers include limited access to finance, gender norms and stereotypes, limited land ownership rights, and the unequal distribution of unpaid care work. However, the Rwandan government's commitment to gender equality and women's empowerment has helped create an enabling environment for women's economic participation and progress.

5. FDI in different sectors - Which are doing Best and which Need More Support?

Foreign Direct Investment (FDI) has been crucial in the economic development of Rwanda across various sectors. The Rwandan government has actively pursued policies to attract FDI and diversify the country's economy. Here is an overview of FDI in different sectors of Rwanda:

5.1. Manufacturing and Industrial Sector

FDI in the manufacturing and industrial sectors has contributed significantly to Rwanda's economic growth. In 2020, the manufacturing sector received \$98.1 million in FDI inflows [31].

5.2. Infrastructure and Construction

Rwanda has witnessed substantial FDI in infrastructure and construction, particularly in developing transportation networks, energy generation, and real estate. The construction sector received \$167 million in FDI inflows in 2020 [31].

5.3. Services Sector

The services sector, including finance, telecommunications, and tourism, has been a key recipient of FDI in Rwanda. In 2020, the services sector attracted \$72.2 million in FDI [31].

5.4. Agriculture and Agribusiness

FDI in the agricultural sector has contributed to the modernization and commercialization of Rwanda's agriculture. It has helped improve productivity, value chain development, and export-oriented agriculture. In 2020, the agricultural sector received \$37 million in FDI inflows [31].

5.5. ICT and Innovation

Rwanda has actively promoted FDI in the information and communication technology (ICT) and innovation sectors. The government's focus on creating a conducive environment for tech startups and innovation has attracted investments in areas such as digital services and e-commerce. In 2020, the ICT sector received \$19.3 million in FDI inflows [31].

These figures demonstrate the significant role of FDI in Rwanda's economic development and the diversification of its sectors. The government's efforts to improve the business environment, infrastructure development, and investment promotion have contributed to attracting foreign investment in various sectors.

6. Tax Regime for Foreign Companies

Foreign companies operating in Rwanda are subject to the country's tax regime, which aims to create a conducive business environment while ensuring a fair and transparent tax system. Here is an overview of the tax regime for foreign companies in Rwanda:

6.1. Corporate Income Tax

Foreign companies in Rwanda are subject to a standard corporate income tax rate of 30%. However, certain sectors, such as mining and petroleum, have specific tax provisions.

6.2. Value Added Tax (VAT)

Foreign companies are mandated to register for VAT when their annual turnover exceeds a certain threshold, which is currently set at 20 million Rwandan Francs. VAT is levied at a standard rate of 18% on most goods and services, with some exemptions and reduced rates for specific categories.

6.3. Withholding Tax

Foreign companies may be subject to withholding tax on certain payments made to non-residents, including royalties, interest, dividends, and fees for technical services. The withholding tax rates vary depending on the nature of the payment, ranging from 5% to 30%.

6.4. Capital Gains Tax

Capital gains tax applies to gains realized from asset disposal in Rwanda. The tax rate is 5% for both residents and non-residents.

6.5. Double Taxation Agreements (DTAs)

Rwanda has signed DTAs with several countries to avoid double taxation and promote investment. These agreements provide relief or reduced rates on certain types of income, including dividends, interest, and royalties [22].

6.6. Investment Incentives

Rwanda offers various investment incentives to attract foreign companies, including exemptions or reduced rates on corporate income tax, customs duties, and VAT for specific sectors and projects. The exact incentives depend on the size, location, and nature of the investment [23].

7. Conclusion

In conclusion, this paper has provided an overview of Rwanda's economy, focusing on its transformation, dependency on foreign aid, changes in GDP over the years, the structure of the economy in terms of agriculture, food, and tourism, and the future prospects of Rwanda's economy, including its independence from aid. Additionally, it discussed the role of women in the economy, foreign direct investment in different sectors, and the tax regime for foreign companies.

Rwanda has experienced significant economic changes in recent decades, transitioning from a primarily agricultural-based economy to a more diverse one that includes a strong focus on exports. The country has made remarkable progress in terms of political stability, economic growth, and poverty reduction since the devastating genocide in 1994. However, Rwanda remains one of the most aid-dependent countries in the world, and reducing aid dependency is a long-term goal.

The diversification of Rwanda's economy has been supported by sectors such as agriculture, food, and tourism. Agriculture remains a vital sector, employing the majority of the population and contributing to GDP, despite efforts to

promote other sectors. The tourism industry has shown rapid growth, attracting international visitors with its natural beauty and cultural heritage. Rwanda's exports, including coffee, tea, minerals, and tourism services, have experienced significant growth over the years.

Foreign direct investment (FDI) has played a key role in Rwanda's economic development, with investments flowing into manufacturing, infrastructure, services, agriculture, and ICT sectors. The government's commitment to improving the business environment and promoting investment has contributed to attracting foreign capital.

Women in Rwanda have made significant strides in various sectors, including entrepreneurship, agriculture, education, leadership, and political participation. The government has implemented policies to promote gender equality and women's empowerment, contributing to their increased participation in the economy.

The tax regime for foreign companies in Rwanda aims to create a conducive business environment while ensuring fair and transparent taxation. Corporate income tax, value-added tax, withholding tax, and capital gains tax are some of the key elements of the tax system.

Looking ahead, Rwanda's economy shows promise, but challenges persist. The country needs to continue diversifying its economy, reducing its dependence on agriculture, and promoting further investments in sectors with growth potential. Efforts to enhance infrastructure, access to finance, and the business environment will be crucial for attracting more foreign direct investment.

All-inclusive, Rwanda has made noteworthy progress in terms of economic development, but there is still work to be done to achieve sustainable and inclusive growth. With its determination to reduce aid dependency, promote gender equality, attract foreign investment, and improve the business environment, Rwanda is poised to continue its trajectory of growth and development in the years to come.

References

- [1] Pamela Abbott, and Marklin Rucogoza, "Legal and Policy Framework for Gender Equality and the Empowerment of Women in Rwanda," Institute of Policy Analysis and Research – Rwanda, 2011. [Google Scholar] [Publisher Link]
- [2] Pamela Abbott, and John Rwirahira, "Aid Effectiveness in Rwanda: Who Benefits?," Institute of Policy Analysis and Research-Rwanda, 2012. [Google Scholar] [Publisher Link]
- [3] Admin, Tourism Promotion will better the Lives of Rwandans, Official Rwanda Development Board (RDB) Website, 2018. [Online]. Available: <https://rdb.rw/tourism-promotion-will-better-the-lives-of-rwandans/>
- [4] Rwanda - Country Strategy Paper 2022-2026, African Development Bank Group, p. 94, 2022. [Online]. Available: <https://www.afdb.org/en/documents/rwanda-country-strategy-paper-2022-2026>
- [5] Rwanda Economic Outlook, African Development Bank - Building Today, A Better Africa Tomorrow, 2022. [Online]. Available: <https://www.afdb.org/en/countries/east-africa/rwanda/rwanda-economic-outlook>
- [6] Agriculture, Official Rwanda Development Board (RDB) Website, 2020. [Online]. Available: <https://rdb.rw/investment-opportunities/agriculture/>

- [7] David Dollar, and Alberto Alesina, “Who Gives Foreign Aid to Whom and Why?,” DASH Home, 1998. [[Google Scholar](#)] [[Publisher Link](#)]
- [8] Empowering Women Farmers in Rwanda to Grow Better Crops, Better Food and Incomes, (n.d.), UN Women – Headquarters, 2018. [[Google Scholar](#)] [[Publisher Link](#)]
- [9] Government of Rwanda, Socio-Economic Transformation for Rwanda’ Growth and Sustainable Development, Government of Rwanda, 2021. [[Google Scholar](#)] [[Publisher Link](#)]
- [10] Government of Rwanda, Vision 2050, Government of Rwanda, 2020.
- [11] Government of the Republic of Rwanda, (n.d.), Women Representation. [Online]. Available: <https://www.parliament.gov.rw/women-representation>
- [12] IPU Parline. (n.d.), Rwanda - Chamber of Deputies. [Online]. Available: https://data.ipu.org/content/rwanda?chamber_id=13513
- [13] Ksafari, (n.d.), National Agricultural Export Development Board. [Online]. Available: <https://www.naeb.gov.rw/>
- [14] Mining, Official Rwanda Development Board (RDB) Website, 2021. [Online]. Available: <https://rdb.rw/investment-opportunities/mining/#tab-2-3>
- [15] Observatory of Economic Complexity, Tea in Rwanda, OEC - The Observatory of Economic Complexity, 2021. [Online]. Available: <https://oec.world/en/profile/bilateral-product/tea/reporter/rwa>
- [16] Official Rwanda Development Board (RDB), 2023. [Online]. Available: <https://rdb.rw/>
- [17] Dr. Prof. Dong Hwa Kim, "A Study on AI Impact of Post Corona-19 in Africa," *SSRG International Journal of Economics and Management Studies*, vol. 7, no. 8, pp. 6-19, 2020. [[CrossRef](#)] [[Publisher Link](#)]
- [18] Rwanda (RWA) Exports, Imports, and Trade Partners, (n.d.). OEC - The Observatory of Economic Complexity. [Online]. Available: <https://oec.world/en/profile/country/rwa>
- [19] Rwanda Development Board, *Annual Report 2019 (RDB ANNUAL REPORT 2019)*, RDB, 2019. [[Publisher Link](#)]
- [20] Rwanda Development Board, (n.d.). Coffee Sector | Official Rwanda Export Website. [Online]. Available: <https://rdb.rw/export/export/products-directory/coffee-sector/>
- [21] Rwanda Development Board, (n.d.). Official Rwanda Export Website. [Online]. Available: <https://rdb.rw/export/>
- [22] Rwanda Revenue Authority. [Online]. Available: <https://www.rra.gov.rw/en/home>
- [23] Rwanda Standard Incentives for Investors, (n.d.), East African Community. [Online]. Available: <https://www.eac.int/investment-climate-and-incentives/investment-incentives/243-sector/investment-promotion-private-sector-development/investment-guide/2475-rwanda-standard-incentives-for-investors>
- [24] Rwanda Summary, Encyclopedia Britannica, 2021. [Online]. Available: <https://www.britannica.com/summary/Rwanda>
- [25] Rwanda: How the Genocide Happened, BBC News, 2011. [Online]. Available: <https://www.bbc.com/news/world-africa-13431486>
- [26] Ann Veiderpass, and Per-Ake Andersson, “Foreign Aid, Economic Growth and Efficiency Development: A Data Envelopment Analysis Approach (SADEV REPORT 2007:01),” Swedish Agency for Development Evaluation, 2007. [[Google Scholar](#)] [[Publisher Link](#)]
- [27] World Bank, Rwanda: Systematic Country Diagnostic (138100-RW), World Bank Group, 2019. [[Google Scholar](#)] [[Publisher Link](#)]
- [28] World Bank Open Data, 2021. [Online]. Available: <https://data.worldbank.org/indicator/SE.PRM.ENRR.FE?end=2021&locations=RW&start=2021&view=bar>
- [29] World Bank, Agriculture, Forestry, and Fishing, Value Added (% of GDP) – Rwanda, 2021. [Online]. Available: <https://data.worldbank.org/indicator/NV.AGR.TOTL.ZS?locations=RW>
- [30] World Bank, World Bank Open Data, 2021. [Online]. Available: <https://data.worldbank.org/indicator/NE.EXP.GNFS.CD?locations=RW>
- [31] United Nations, World Investment Report 2021 (UNCTAD/WIR/2021), United Nations Conference on Trade and Development, 2021. [[Publisher Link](#)]
- [32] Population Size and Population Characteristics, National Institute of Statistics Rwanda, 2022. [Online]. Available: <https://www.statistics.gov.rw/statistical-publications/subject/population-size-and-population-characteristics>