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Pockets of Effectiveness Working Paper No. 9

The political economy of central bank effectiveness: The case of National Bank of Rwanda

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July 2020

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ISBN: 978-1-912593-62-0

Pockets of effectiveness (PoEs) are public organisations that function effectively in providing public goods and services, despite operating in an environment where effective public service delivery is not the norm. This project, which investigates PoEs in relation to the politics of state-building and regime survival in sub-Saharan Africa, is being led by Professor Sam Hickey, based at the Global Development Institute, The University of Manchester, in collaboration with Professor Giles Mohan (The Open University), Dr Abdul-Gafaru Abdulai (University of Ghana), Dr Badru Bukenya (Makerere University), Dr Benjamin Chemouni (University of Cambridge), Dr Marja Hinfelaar (SAIPAR, Lusaka) and Dr Matt Tyce (GDI,The University of Manchester). It is funded by the Economic and Social Research Council and Department for International Development with some additional funding from the DFID-funded Effective States and Inclusive Development Research Centre.
http://www.effective-states.org/research/pockets-of-effectiveness/

Abstract

In a survey conducted in Rwanda by the Pockets of Effectiveness project, the Central Bank was listed as among the top-performing government organisations in the country. This paper examines the political determinants of the portrayal of the National Bank of Rwanda's (BNR) achievement of its mandate: promoting price and financial stability. The paper uses the political settlements framework to highlight the political determinants of financial sector reforms in the country. Rwanda's underlying political economy – and particularly the government's evolving relationships with domestic capital vis-à-vis foreign capital – has contributing to shaping the Rwandan financial sector's trajectory. In particular, the Rwandan government has prioritised a strategy of being a financial sector hub, which is based on increased global financial integration and portraying the achievement of 'best practice' reforms. These goals have come at the cost of traditional developmentalists goals for central banks, including direct lending for structural transformation. BNR has achieved success in its mandate. However, achieving success in its market-led mandate reduces the policy tools at its disposal to promote structural transformation. The paper argues that reforming BNR along neoliberal lines has mirrored the broader macro-strategy of the country, with the ruling Rwandan Patriotic Front (RPF) choosing to rely increasingly on legitimacy with external actors, rather than supporting the growth of strengthening domestic state–business relationships to support economic transformation.

Keywords: Rwanda, pocket of effectiveness, Africa, banks, finance, political settlement

Acknowledgments: This paper was a product of research funded by both the Effective States and Inclusive Development Research Centre (ESID) and the Economic and Social Research Council (ESRC)-funded University of Oxford-led project on Navigating Global Banking Standards. Emily Jones, Sam Hickey, Benjamin Chemouni and Merilee Grindle, as well as anonymous reviewers, provided thoughtful and constructive feedback that has improved this paper.

Behuria, P. (2020) The political economy of central bank effectiveness: The case of National Bank of Rwanda. Pockets of Effectiveness Working Paper No. 9. Manchester, UK: The University of Manchester. Available at www.effective-states.org

The background research for this paper was funded by the Effective States and Inclusive Development Research Centre (ESID), based at The University of Manchester, UK. This document is an output from a project funded by UK Aid from the UK government for the benefit of developing countries. However, the views expressed and information contained in it are not necessarily those of, or endorsed by the UK government, which can accept no responsibility for such views or information or for any reliance placed on them.

Introduction

Late developing countries face conflicting pressures in reconfiguring their financial sectors to support economic transformation in the 21st century. The pressures of structural adjustment contributed to decades of attack on state control of the financial sector, with two-thirds of World Bank loans issued to African countries between 1980 and 1995 including conditions related to financial sector liberalisation (Arriola, 2018). More recently, African countries have been encouraged to invite foreign investment into those sectors, as a way to guard against financial crises (Stein, 2010).[1] Alongside financial liberalisation and narrow-minded central bank mandates restricted to conservative goals of maintaining price stability, the economic prosperity enjoyed by tax havens – like Mauritius – has contributed to many African governments also considering establishing global financial centres. Most African countries have remodelled their financial sectors (to varying degrees) in line with idealised 'best practice' financial standards of adopting inflation targeting (IT) monetary frameworks and adopting Basel financial standards.

It is clear that the traditional 'developmentalist' role of central banking, focused on the mobilisation and allocation of long-term finance for industrialisation (Amsden, 2001; Epstein, 2013), has receded in importance globally. In the early 1970s, influential mainstream scholarship (Shaw, 1973; McKinnon, 1973) refuted the need for a 'developmentalist' role for central bank and, instead, argued that financial deregulation would stimulate growth in developing countries. Shaw and McKinnon's 'financial repression' hypothesis claimed that interest rates in developing countries were too low because of interest rate controls. Instead, they proposed deregulation, which would liberate financial markets and increase interest rates, motivating the domestic population to increase savings and investment.[2] This recommendation figured prominently in the Washington Consensus. International financial institutions (IFIs) (like the World Bank and the International Monetary Fund) have pressured African governments to reform their financial systems away from the traditional 'financial repression' or 'developmentalist' model since the 1980s (Karwowski and Stockhammer, 2017).[3]

Central banks in developing countries (particularly, in most African countries), in line with Modern Monetary Theory, are increasingly working towards prioritising retaining low inflation rates, central bank independence and mirroring financial best practices in the West (including Basel financial standards).[4] Yet, within the constraining environment of global financial governance, African central banks have adopted

[1] Mkandawire (1999) argues that financial liberalisation has resulted in an era of increased financial crises in Africa. Nigeria's rapid liberalisation after the 1990s is a case in point (Lewis and Stein, 1997).
[2] See Karwowski and Stockhammer (2017) for a critical review of these arguments.
[3] See Lewis and Stein (1997) for an account of the influence of the international financial institutions in financial sector reforms in Nigeria.
[4] See Jones and Zeitz (2019), Jones (2020) for a critical review of the engagement of developing countries with Basel reforms.

diverse strategies of reforming their financial sectors.[5] This variation is evident across the case studies of ESID's Pocket of Effectiveness project, with Zambia rejecting adopting Basel standards and Rwanda recently becoming among the continent's most ardent adopters (Behuria, 2020a).

Since 1994, The National Bank of Rwanda (BNR) has reformed Rwanda's financial sector in the face of what appears to be three contradictory pressures. First, the IFI model of financial liberalisation, inflation targeting, financial inclusion and regulatory best practice, including adhering to Basel financial standards. Second, retaining some prioritisation for directing investments to strategic sectors to support economic transformation. Third, reforming the financial sector in line with becoming a regional financial hub, borrowing from the models of low-tax jurisdictions like Jersey and Mauritius. By 2024, a key priority in Rwanda's National Strategy for Transformation is to become 'a hub for financial services to promote investments' (GoR, 2017). Clearly, BNR's reforms have worked alongside substantial progress in socio-economic indicators. During 1999-2014, Rwanda's annual GDP growth was 7.7 percent and its annual growth in GDP per capita was 5 percent (Diao and Mcmillan, 2018). There has also been substantial progress in socio-economic indicators including health and education (Abbott Sapsford and Binagwaho, 2017; Chemouni, 2018).[6] In a survey of 23 respondents in Kigali in July-September 2017, BNR was recognised as being the fifth-highest performing state organisation (Chemouni, 2019).[7]

This paper examines the politics of BNR's financial reforms since 1994, showcasing in particular how achieving its successful mandate in promoting price stability and financial stability indicators was achieved. Clearly, there has been progress in both indicators. However, the paper highlights some inconsistencies in data, and questions whether BNR's successful portrayal of effectiveness is as effective (even on the terms it portrays). The veneer of 'effectiveness' appears to have impeded the use of instruments to promote structural transformation. Despite the appearance of central bank autonomy, this paper showcases how the limited distance between the presidency and the central bank has motivated reforms in the financial sector. In particular, political vulnerability within the ruling coalition has motivated the choice to reduce reliance on domestic capitalists and increase the government's reliance on externally based actors for capital, legitimacy and investment. This paper builds on fieldwork between 2011 and 2018 on the country's banking sector. Forty-six interviews have been conducted with BNR representatives, other government officials, representatives of all commercial banks in the country, consultants and other stakeholders relevant to the financial sector. Research has been supported by the Effective States and Inclusive Development Research Centre and the University of Oxford's Blavatnik School 'Navigating Global Banking standards' programme.

[5] See Grabel (2017) for a discussion of the 'pluripolar' characteristics of global financial governance.
[6] However, Williams (2017) shows that a focus on quantitative measures like enrolment have not been accompanied by similar progress in learning in Rwanda.
[7] See Hickey (2019) for a discussion of the survey methodology.

This paper begins with an exploration of the existing literature regarding financial sector reform in Africa. Next, it discusses the evolving political settlement in Rwanda in relation to financial sector reforms in the country. The following sections detail the politics shaping BNR's performance over the last two decades in reference to price stability and financial soundness indicators. The paper ends with a discussion of the developmental implications of BNR's successful portrayal of effectiveness.

Analysing central bank effectiveness amid varieties of global financial integration in Africa

During the colonial era, there was significant diversity in the structure of financial sectors across African countries. However, most banking systems were largely used to support the administration and firms of the colonial economy. With independence, most African countries either chose to nationalise and restructure foreign banks or establish new financial institutions (Mkandawire, 1999). In the 1950s-1970s, African governments reformed their financial sectors in line with the broader consensus of economic thinking at the time, which envisioned the role of the banking sector as supporting goals of promoting structural transformation, often through import-substitution industrialisation. Globally, there was consensus around the important role that the state should play within the financial sector, because of the disastrous influence of private finance in the global depression in the 1930s. African countries, too, used the banking sector for similar purposes and developed financial instruments like development banks to fund structural transformation.

In the 1970s, the 'paradigm shift' within development thinking, which laid the foundation of the Washington Consensus, not only attacked import substitution industrialisation and the state's role of the economy, but also the state's role in the financial sector (Krueger, 1974; World Bank, 1981). The 'financial repression' model, made popular by Shaw (1973) and McKinnon (1973), was employed within structural adjustment programmes across the continents, with 'getting interest rates right' the new mantra for financial sector reforms. Later, the World Bank strongly urged countries to liberalise their financial sectors and remove capital controls. Across many African countries, there was eager adoption of the World Bank's proposals to reform financial sectors (though there was variation in adoption of reforms).[8] This has often been interpreted as central bankers learning from what was perceived to be best practice (and past failures), thus being convinced to adopt conventional wisdom. However, Mkandawire (1999: 336) argues that 'such a Pauline change of heart' among bankers who once advocated state intervention in finance to promote structural transformation ignores 'the hegemonic positions of Bretton Woods Institutions (BWIs) in the economy'. Across many African countries, BWIs influenced the appointments of chairpersons of central banks for the next two decades, with 'financial repression' increasingly reinforced both domestically and externally in relation to global performance indicators.

[8] See Boone (2005).

The new focus on 'central bank independence' was based on an assumption about a central bank independence-inflation-growth-nexus, suggesting that central bank independence would contribute to reduced inflation, which would lead to increased growth. The underlying logic was based on the premise that greater autonomy of bankers (and their depoliticisation) would lead to lower inflation and insulate monetary politics from Africa's corrupt or neopatrimonial politics.[9] In effect, the projection of independence from domestic politics led to increased dependence externally, with African central bankers increasingly reliant on BWIs for recognition of their monetary policies and training of their workforce. Thus, Mkandawire (1999: 327) argues, African central bankers that 'parade their newly acquired independence' are actually 'African converts (to IFI models) who are more catholic than the pope' because the International Monetary Fund (IMF) itself has become more interested in political issues around governance. Thus, the nature of central bank accountability transformed from one where the central bank was responsible for supporting growth and employment-conscious industrial policies, to an external accountability towards the IFIs (Epstein and Yeldan, 2009).

Though IFIs continue to hold sway on financial sector reforms in Africa, the diverse ways in which African governments have sought to restructure their financial sectors in relation to global financial governance suggests the continued importance of domestic political economy in reshaping financial sector policies. Financial liberalisation and reducing capital controls are policies aimed at attracting foreign investment. Till the 1970s, countries set interest rates below the 'world market interest' without fear that capital flight occur because they controlled capital movements or because global financial markets had not reached a position where they could force the equalisation of interest rates (Mkandawire, 1999). Now, the attraction of foreign investment (and, for African elites, finding safe havens for their own money) has contributed to some African governments signing double taxation treaties with low-tax jurisdictions or aiming to mimic Mauritius, Singapore, Dubai in becoming low-tax jurisdictions themselves. Though some adherence to the IFI model is necessary to become a global financial hub, IFIs have rarely supported such strategies, including in the case of Mauritius. Rwanda, too, has double tax treaties with Barbados, Belgium, Jersey, Mauritius, Morocco, Singapore and South Africa. Additionally, Rama Sithanen – former Finance Minister of Mauritius and among the key individuals behind the development of Mauritius' tax haven – has been a member of President Kagame's Presidential Advisory Council for over a decade. In November 2019, Rwanda established the Kigali International Finance Centre to explicitly mimic offshore centres like Mauritius and Singapore

The next section describes how Rwanda's evolving domestic political settlement, in interaction with external pressures, has shaped the priorities of BNR.

[9] See Maxfield (1998) for critical engagement with the focus on central bank independence. See Mkandawire (2015) for a critical treatment of African studies' obsession with characterising African countries as neopatrimonial societies.

Rwanda's political settlement and the banking sector

The political settlements framework, initially developed by Mushtaq Khan (1995, 2010, 2018), emerged out of a critique of dominant new institutional economics (NIE) frameworks in the 1990s. NIE frameworks and assumptions provided the foundation for the prevailing good governance agenda, which continues to shape most development policymaking today. Unlike the influential work of Acemoglu and Robinson (2012), who treat power as decontextualised from economic structure, the political settlements approach is rooted in historical materialism (Goodfellow, 2018; Di John and Putzel, 2009). The political settlements approach helps us analyse how the distribution of power in societies affects policymaking across sectors and the broader macro-economy. Because investments from the financial sector inevitably shape the trajectory of growth in national economies, the political settlements around financial sectors – particularly, the contestation of power between groups around rents and ideational framings of policymaking – must be more central in our analysis of the prospects for late development in the 21st century. Using political settlements frameworks can thus add to the increasing recent literature on the political economy of African financial sectors (Dafe, 2019; Ferreira and Soares de Oliveira, 2019; Jones, 2020).

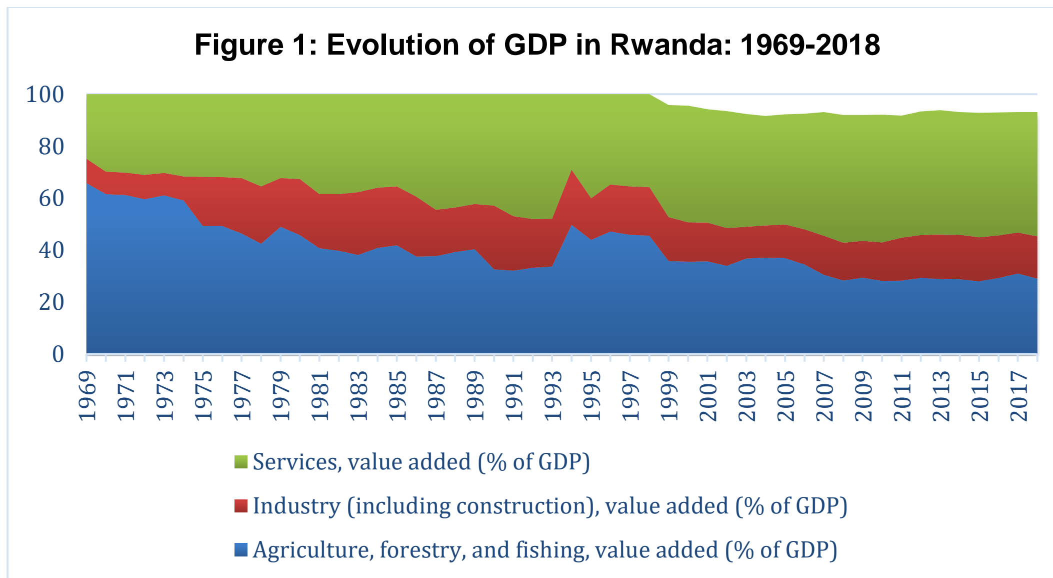
ESID work, along with other recent publications, has built on existing political settlements framework to extend political settlements analyses in two directions. The first has been to showcase how transnational power coalitions interact with domestic political economy pressures to influence policymaking in developing countries (Lavers and Hickey, 2016; Franz, 2018; Behuria, 2020b). Such work highlights one way to combine a focus on domestic and international levels of analyses, which so often eludes most political analysis (Gore, 1996; Hickey, Sen and Bukenya., 2015). The second is to highlight how ideas and ideational frames may influence policymaking (Hickey, 2013; Behuria, 2016; Chemouni, 2018; Lavers, 2018; Gray, 2018).

Since the genocide, and primarily after 2000, the RPF has been widely cited (Golooba-Mutebi, 2013; Goodfellow, 2014; Behuria, 2016; Behuria and Goodfellow, 2016; Williams, 2017; Chemouni, 2018) as an example of a 'potential developmental coalition' or 'strong developmental regime' in line with existing political settlements frameworks (Khan, 2010; Whitfield et al., 2015). Characterising Rwanda in this way suggests that factions excluded from the ruling coalition are relatively weak, as are lower-level factions within the ruling coalition itself. The logic follows that the interests of the ruling coalition are strongly aligned with growth. And that the ruling coalition has strong implementation. Thus, BNR's appearance as an effective government organisation should not be surprising, given that most government organisations should be effective if the macro-level political settlements analysis of Rwanda is correct. However, this does not tell us why the BNR has chosen to prioritise different mandates over others.

To analyse why BNR has promoted a broad mandate of 'neoliberal convergence' and the presentation of alignment with IFI 'best practice', the following paragraphs describe how domestic politics has motivated Rwanda's ruling coalition to embrace the presentation of neoliberal convergence with financial sector reforms. Though the Rwandan government could be classified as a potential developmental coalition since around 2000, the apparent political stability associated with this classification obscures the divisive nature of political contestation since then.

In 1994, the Rwandan Patriotic Front presided over a broad-based government, with Pasteur Bizmingu and Faustin Twagiramungu, both Hutus, named President and Prime Minister, respectively. Current President, Paul Kagame, served as vice president of Rwanda between 1994 and 2000. Gradually, though, there were increasing political difficulties with Hutu leadership within the RPF (Reyntjens, 2013; Prunier, 2008). By the early 2000s, several prominent Hutu politicians had been arrested or had left the country and formed opposition parties abroad. Soon after, in the early and mid-2000s, elite friction within Tutsi segments of the RPF became increasingly divisive and surfaced publicly (Reyntjens, 2011; Kimonyo, 2019). High profile political and military officials, including Kayumba Nyamwasa, Theogene Rudasingwa, Gerald Gahima and Patrick Karegeya, were among senior RPF cadres who left the country, forming the Rwanda National Congress (RNC). Another spate of concentration of control among former RPF liberation fighters continued into the 2010s, with large-scale retirements within the military in the 2010s and the retirement, exile or imprisonment of some other former senior RPF figures (Behuria, 2016). Gradually, Rwanda's ruling coalition, led by President Paul Kagame, has reduced its reliance on former RPF liberation fighters. Instead, Kagame's ruling coalition has attempted to widen its sources of legitimacy domestically and externally. Domestically, this has resulted in political tensions, with former RPF figures regularly accused of allying with opposition parties operating in exile (like the RNC) classified as enemies of the state. Neighbouring countries (like Uganda) have also been caught in the crossfire, accused of allying with opposition figures and the RNC and former RPF allies-turned-enemies, like tycoon Tribert Rujugiro.

Rwanda's position as a landlocked, densely populated country in Central Africa has also meant that the RPF government has perceived regional and continental integration, as well as global connectivity, as the only pathway to long-term economic security. This strategy is similar to other countries, which have previously perceived themselves to be geographically disadvantaged, including Singapore and Mauritius. In the 2000s, the government chose to increasingly present the idea of becoming a hub of connectivity of different forms, including finance, tourism, air traffic and even regional economic mining and agricultural hubs. Thus, increasing global engagement and economic openness has been part of the development strategy of Rwanda, as part of VISION 2020 and beyond (GoR, 2000). Figure 1 details the evolution of agriculture, industry and services as a share of GDP in Rwanda. A services-based development strategy has contributed to services sectors becoming key drivers of growth (Behuria and Goodfellow, 2019).



Increasing reliance on an externally dependent development strategy may have also been partially motivated by the continuing frictions with domestic capitalists within the country. The evolution of the state's relationship with domestic capitalists within the financial sector provides reasonable evidence for this claim. The government's fractious relationship with domestic capitalists over time also supports this. Additionally, no privately owned domestic firm (aside from party- and military-owned enterprises) retains large market share in any significant sector and a consistent preference shown for foreign investment over supporting domestic firms recently (Behuria, 2018a). The RPF's strategy has been to exert its dominant position through its economic strategy by replacing its traditional partners (RPF liberation fighters and domestic business allies) with an externally dependent strategy, based on attracting foreign capital and global economic integration. The following sections detail the politics of financial liberalisation within Rwanda.

History of pre-1994 finance in Rwanda

The monetary history of Rwanda is strongly linked to the Great Lakes region and to commercial markets in the Belgian Congo and Burundi. The Bank of the Belgian Congo was established and, in 1927, the currency issuing authority of the Bank of the Belgian Congo was extended to Ruanda-Urundi. In 1944, the National Bank of Belgium took over regulation of exchange rate control over the region. During this period, other banks had begun operations in the Congo. The Bank of the Belgian Congo no longer 'played the role of the bank of banks' (BNR 2014: 2). In 1952, the Central Bank of Belgian Congo and Ruanda-Urundi was established and took over the responsibilities of the Bank of Belgian Congo. In 1960, the Congo became independent and *Banque d'Emission du Rwanda et du Burundi* (BERB) established operations as an issuing bank in Rwanda and Burundi.

Rwanda and Burundi both became independent in 1962. The National Bank of Rwanda (BNR) was established in 1964, with the mission 'to maintain monetary stability, implement credit and exchange rate policies conducive to harmonious

economic development, issue national currency and play the role of the Government treasurer' (BNR 2014: 4). In the 1960s, BNR was responsible for monitoring three financial institutions. *Caisse Sociale du Rwanda* (CSR) was established in 1962 and the Rwanda Savings Fund (*Caisse d'Epargne du Rwanda*) and the *Banque Commerciale du Rwanda* (BCR) – Rwanda's first commercial bank – were established in 1963. Bank of Kigali (BK) began operations as a commercial bank in 1966, followed by *Banque Continentale Africaine du Rwanda* (BACAR) in 1983. The Rwanda Development Bank (BRD) was established in 1967 and Union des Banques Populaires du Rwanda, which later became Banque Populaire du Rwanda (BPR) – a microfinance cooperative with 146 branches created in 1975. In the 1960s and 1970s, BNR prioritised ensuring macro-economic stability by providing short-term financing to the central government to smooth over tax revenue fluctuations. Financing never exceeded 50 percent of annual government revenues and loans were paid back after the first quarter of the following budget year (BNR 2014).

Prior to 1994, the national government retained significant control over the domestic commercial banking sector, with the government retaining shares in all three commercial banks. Though the government agreed to reduce its control of the financial sector as part of the structural adjustment programme agreed in 1990, no policies were put in place after 1994. The government shared ownership of BCR with *Banque Bruxelles Lambert*. The government owned 51 percent of BCR's share capital, although other reports claim that the government retained 42 percent of BCR's share capital (Goldmark, 1987). BK was established as a joint venture with *Belgolaise SA*. Later, *Banque Nationale de Paris* and Dresdner Bank also invested in the bank. The government retained 50 percent of BK's share capital. *Banque Continentale du Luxembourg* retained a majority of shares in BACAR, with independent Rwandan investors also owning some shares and the government retaining 4 percent of shares. Initially, BACAR – as the only privately owned bank – was said to enjoy more flexibility than other banks and 'aimed to attract the top-end of the market to its doors' (Goldmark, 1987: 31). In 1985, over 83 percent of all loans provided by banks were short-term loans. The only long-term loans that commercial banks were allowed to make were for staff housing construction (Goldmark, 1987). In the 1980s, BCR was the largest bank, while BK was the second largest. BACAR was comparatively much smaller.

In 1981, BNR missions were expanded to the 'formulation of the monetary policy, the credit and exchange policy to support the implementation of the Government economic policy and ensure the internal and external stability of the national currency' (BNR 2014: 4). Although the BNR attempted to increase its mandate, reports (BNR, 2014) indicate that the banking sector lacked access to training programmes and was weakened by technical skills deficits.

Prior to 1994, the banking sector remained shallow. Before 1994, the three commercial banks had fewer than 20 branches across the country. Rwanda's financial sector had not been effectively used as a source of developmentalist

Table 1: The politics of central banking in Rwanda

Period	Indicators	Political settlement dynamics	Leadership and autonomy	Organisational culture	Transnational factors	Ideas
1994-early 2000s	Unhealthy indicators, with high inflation.	Gradual concentration of power among senior RPF leadership around President Kagame.	Formally adopted central bank independence, but remains closely connected with senior RPF leadership.	Limited. BNR is being re-organised after the genocide.	Aid dependent, but Rwanda retains policy space to rebuild economy.	BNR leaders formally adopt IFI suggestions, but allow direct lending to rebuild the economy.
Early 2000s-2013	Inflation and broader financial sector indication steadily improve.	Financial liberalisation adopted as a strategy to support the marginalising of domestic capitalists and rival RPF cadres.	BNR adopts formal position to becoming regional banking hub and attempts to evolve practices in line with harmonisation of East African standards and 'best practices' proposed by IFIs.	BNR developing organisational culture. All training conducted by international financial institutions.	IFI influence remains strong and tallies with the preferred policies of BNR's leadership. Economy remains structurally weak and susceptible to commodity price fluctuations and aid withdrawals (as occurred in 2012).	BNR adopts a formal trajectory towards discussing the adoption of an inflation-targeting framework and aims to become a high adopter of 'best practice' financial standards (in line with IFI proposals).
2013-current	All financial indicators have steadily improved.	Increased political contestation within the RPF, but personalisation of power is consolidated among senior RPF leadership.	BNR takes steps to adopt an inflation-targeting framework. BNR retains consistency in leadership, but relies on IFIs for recognition of progress.	BNR strengthening organisational culture. However, staff continue to leave for commercial banks (especially after entry of new banks).	Aid withdrawn in 2012 weakens economy. IMF provides stand-by credit facility. Increased reliance on IFIs for training and 'best practice' suggestions.	BNR adopts Basel II and III banking standards concurrently and rapidly implements them. BNR formally adopts IT monetary framework.

banking. This was despite the Rwandan government establishing the Development Bank of Rwanda (BRD) in 1967, with the sole aim of providing long-term financing for economic diversification. Although the BRD had a record of providing preferential

interest rates and long-term financing for strategic projects in the 1970s and 1980s, most investments were mismanaged or favoured the ruling party.[10] The limited success in economic diversification suggests that most BRD investments outside the agriculture sector did not yield the benefits intended. After the genocide, priorities shifted –as a result of both a new government coming to the power and the RPF's reliance on the World Bank and other donors as a source of financing. Table 1 provides a brief illustration of how political settlement dynamics have influenced central bank priorities in Rwanda.

Political economy of the post-1994 financial liberalisation

Rwanda's financial sector has grown substantially since 1994 and, in recent years, it has been among the fastest growing sectors in the country (Behuria and Goodfellow, 2016). Rwanda's economy continues to be dependent on primary commodity exports. Coffee, tea and minerals still represented more than 65 percent of exports at the end of 2016. Throughout Rwanda's independent history, a reliance on primary commodity exports has left the political economy vulnerable to global commodity price fluctuations. Several periods of political vulnerability were preceded by commodity price fluctuations in pre-1994 Rwanda (Prunier, 1995). In post-1994 Rwanda, global commodity price fluctuations have contributed to increasing trade deficits and shortages in foreign exchange. These external shocks have often forced reactions from the Rwandan government in terms of shifting economic policy. But, more importantly, vulnerability in the country's economic structure has contributed to how the Rwandan government has aimed to achieve its goal of achieving self-reliance within the 21st century global political economy. For the Rwandan government, because of the country's geographical weaknesses, an ambitious goal of becoming a financial sector hub, supported by global economic integration, was prioritised.

This has included a significantly liberalised financial sector since 1994. As of July 2017, there are 11 commercial banks operating in Rwanda, four microfinance banks, one development bank and one cooperative bank. As of 2016, there were 177 branches spread across the country and the government claimed that 89 percent of Rwandans were 'financially included'. The banking system comprises the largest share of financial sector assets at 66.3 percent, as of June 2016 (BNR, 2016). This has decreased over the years, reducing from 70.8 percent in 2011. Pensions, microfinance institutions and savings and credit cooperatives contribute the remaining banking sector assets. Annex 1 lists the commercial banks (and the ownership structures of these banks) operating in Rwanda.

Initially, the government liberalised through relying on capital from domestic businesspeople. After the genocide, the government licensed two new commercial banks – Bank of Commerce, Development and Industry (BCDI) and *Banque à la*

[10] Directed lending naturally requires a degree of political connections, so this statement is not surprising, especially coming from current government officials. Interview, mid-ranking BRD official, January 2015.

Confiance d'Or (BANCOR). Domestic businessmen – closely tied to the RPF – were lead investors in these banks. Alfred Kalisa was among the investors who led BCDI. In 2000, now exiled and former prominent Rwandan businessman Tribert Rujugiro gained ownership of BANCOR in 2000. BACAR's ownership also changed in 1995. *Banque Continentale du Luxembourg* sold its shares to a group of Rwandan businessman, with Valens Kajeguhakwa a leading member of the group of investors who partnered with the government to take over BACAR's assets. In 1999, more than 40 Rwandan investors and state-owned institutions (which owned a minority share) established *Cogebanque*. Though the commercial banking sector was liberalised, it was closely managed. Only trusted loyal investors in the sector were trusted and foreign investment was not encouraged.

During the 1990s, there was a sharp increase in non-performing loans across the banking sector. Non-performing loans increased from 10 percent in 1993 to 20 percent in 1997 to 60 percent by mid-1999 (Kimonyo, 2019: 163). The most positive interpretation of this trend would argue that the RPF and close allies were providing directed lending to trusted and close allies to invest and help re-build the country, with no hope for return on investments. More cynically, one could argue that the banking sector was used as an instrument to enrich supportive elites within the country during a period when the country's future stability was still at risk. In the late 1990s, a foreign auditor found that three banks – BACAR, BCR and BDI – were guilty of dubious practices, with 'even the most basic rules for granting credit not respected' (Kimonyo, 2019: 163). The IFIs suggested that commercial banks should not be saved by government money and argued that this was an opportunity for liberalisation (ibid; Behuria, 2018b). Kimonyo (2019), from his position in the Office of the President, argues that this was 'a political opportunity to put an end to a source of political difficulties'. The government seized the opportunity to invite foreign investors to recapitalise these banks. See Behuria (2018b) for a detailed discussion of the politics of liberalisation in Rwanda's financial sector. Annex 1 provides details of ownership of Rwanda's existing commercial banks.

This incident is essential to help illuminate how reforms evolved in the country's financial sector. Inviting foreign investment was a pathway to reduce the government's reliance on domestic capital. The battle against corruption also became closely associated with the reduced reliance on domestic political and economic elites. In the early and mid-2000s, elite frictions within the RPF had also become increasingly politically visible (Behuria, 2016). During this phase, key shareholders in two of the banks named in the auditor's report – Kajeguhakwa and Kalisa – were accused of embezzling funds from their banks in the mid-2000s. Kajeguhakwa later fled the country and Kalisa was imprisoned.

Though the government's attempts to use privately-owned commercial banking for direct lending was less evident in successive years, there were still other financial instruments available to direct strategic investments for economic growth and transformation. BK remained under majority government control until recently and remains the largest bank in the country. BRD has also remained a source of long-

term financing. Yet BRD's funds have not been effectively employed in structural transformation. Instead, BRD has been mired in controversy. This is not surprising. In most countries, strategic investments would often only be open to a select group of closely allied elites. Since the RPF government has had an increasingly fractious relationship among its own elites (particularly Rwandan business elites), the financial institution (BRD) used to support strategic actors has remained a source of anxiety for the RPF's leading figures. At least five former executives of BRD have been imprisoned or left the country in exile (Himbara, 2018). This suggests that the vulnerability faced by the RPF among its own elite group has reduced possibilities for strategically financing structural transformation.

The late 1990s/early 2000s was a period of significant political shifts within economic leadership in Rwanda. During the early 2000s, commodity price fluctuations also exposed the structural weaknesses within Rwanda's banking sector. Francois Kanimba, who had worked in BNR previously and was the chairman of the Governance Task Force, which negotiated Rwanda's first structural adjustment programme (SAP), was appointed as BNR governor in 2002. Kanimba's position in agreeing the SAP made him a favoured ally of the IFI consensus on financial sector reforms. During Kanimba's nine-year tenure, Rwanda's financial sector became increasingly aligned with global financial standards. One senior Ministry of Finance and Economic Planning (MINECOFIN) official highlighted that 'in the 2000s, our focus was to work with our East African partners in harmonising standards and in cleaning up the banking sector. We needed to get the right investors in our commercial banks.'[11] Since then, Gatete and Rwangombwa's tenures as BNR governor have represented continuity rather than a substantial break in policies. The only clear difference between the tenures of Gatete and Rwangombwa has been that the latter chose to rapidly prioritise financial inclusion (thus temporarily increasing non-performing loans in microfinance institutions).

Attracting regional investors, rather than relying on domestic businesspeople within the sector, was a strategic focus for BNR during the early 2000s. The schisms that appeared among prominent RPF elites in this period continue to exist today. Ecobank would eventually take over Kalisa's BCDI, which was 'known for insider lending' and Kanimba (a Hutu) was made responsible for managing the sales of banks owned by RPF insiders.[12] Some mentioned that Kanimba's position as an outsider (Hutu) helped the RPF present him as a technician, enacting liberalisation policies that donors called for.[13] As the appearance of central bank independence grew, it reduced the capacity for *politicised connections* necessary for patient direct lending to succeed. As an emphasis on *technocracy* increased, the government became increasingly dependent on IFIs for advice, with the IFIs holding sole authority over what was considered 'technical expertise'.

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[11] Interview, senior MINECOFIN official, January 2015.
[12] Interview, senior MINICOM official, June 2017.
[13] Interviews, businesspeople and senior RPF officials, January 2015 and June 2017.

In contrast to other ministries in Rwanda, where reshuffles of top leadership have occurred with consistent frequency, there has been a striking level of stability within BNR. For example, there have been six ministers of finance and economic planning since 2002: Donald Kaberuka (1997-2005), Nshuti Manasseh (2005-2006), James Musoni (2006-2009), John Rwangombwa (2009-2013), Claver Gatete (2013-2018) and Uzziel Ndagajimana (2018-present). In that same time period, there have been just three central bank governors: Francois Kanimba (2002-2011), Claver Gatete (2011-2013)[14] and John Rwangombwa (2013-present). This would imply a greater autonomy of the central bank for policymaking within the country, a point that is supported by indicators that highlight the independence of Rwanda's central bank (higher than other countries in the PoE study). However, like in any late developing country with a small economy, the line between central bankers and the ruling coalition is thin. Political connections – especially in an authoritarian context – are inevitable. Requiring the appearance of central bank independence ensures BNR officials work within the laws to deliver its mandate. This means that there is less opportunity for central bank 'technocrats' to use personal connections, instead deepening the centralisation of power of the ruling coalition.

As BNR experienced relative consistency in terms of its leadership and strategic direction, substantial investments have been made in training, research and in improving the functioning and transparency of the organisation (in line with global financial standards). BNR retains its own research division, maintaining its own journal – *The Rwandan Banker* – and the *BNR Economic Review*. BNR also claims to have developed its own modelling techniques for managing inflation and financial stability within the country. However, BNR remains heavily dependent on IFIs for training. In the context of rapid liberalisation within the sector, commercial banks have regularly poached 'trained' Rwandans from BNR, forcing BNR to re-invest in IFI training. With limited reflection on heterodox thinking, there is little resistance to the government's trajectory of reforming the financial sector along IFI lines. Ideological contestation of policies is largely non-existent within the central bank (though some individual Rwandan bankers working in commercial banks have often opposed central bank policies). The lack of expertise within BNR in relation to commercial banks is also evidenced by the fact that a majority of steering committees are led by former BNR bankers who now work in commercial banks.

The following section details the politics underlying BNR's presentation of effectiveness in relation to price stability, financial stability and financial inclusion.

[14] Gatete and Rwangombwa swapped positions in 2013.

Politics of BNR's effectiveness

> 'The primary objective of the National Bank of Rwanda's monetary policy is to ensure price stability, contributing to sustained macroeconomic stability.'[15]

> 'The Bank ensures financial stability in a free market economy as it embraces innovations, diversity, inclusiveness and economic integration.'[16]

Since the 2000s, BNR has sought to reform its financial sector in line with goals of mirroring best practices in OECD countries. BNR senior management argues that application of best practice is a foundational step towards becoming a regional and global financial sector hub.[17] There are two central areas of focus that this paper will analyse: price stability and financial stability. There has been significant progress in both goals. These goals are also very much in line with IFI models of 'best practice'. BNR's eager adoption of Basel standards are perhaps the best example of this.[18] The IMF (2015) highlighted that Rwanda already complied with more than 80 percent of Basel core principles, making it among the most compliant countries in Africa (alongside South Africa, Botswana, Morocco, Tanzania and Zambia). However, the proposed application of many of these regulations is out of touch with the existing infrastructure of the country's financial sector.

For example, BNR decided to implement Basel II and III very rapidly and concurrently. By the end of 2013, a draft of the regulatory framework was in place. In 2014, a kick-off event took place, with all managing directors of commercial banks invited. In November 2015, a directive was issued, which required parallel reporting of Basel II capital requirements. BNR has always been 'quick to follow international best practices' and since these were the standards that were offered to them, the target was to achieve those standards.[19] Some commercial bank representatives criticised BNR for 'copy and pasting Basel standards without reflecting on their appropriateness in Rwanda.'[20] Beck et al. (2011) cite this as a common experience among African countries, where complex rules are adopted to follow international best practice (and out of fear that they would be penalized, e.g. in the form of higher international borrowing costs), even if those rules are not appropriate to the country's needs. A BNR official said, 'after FSAP-2 in 2011, the benchmarks that they would be assessed on were based on Basel 2 and 3, so though they didn't tell us to implement Basel, we would be judged on the basis of i.'.[21] Recognition of BNR's effectiveness was thus legitimised on the basis of adoption of global financial standards.

In spite of capacity issues within national banks across the continent, and issues with the quality of financial reporting and the collection of data, the importance of

[15] BNR (2019a).
[16] BNR identity statement on website.
[17] Interview, BNR senior management, June 2018.
[18] See Behuria (2020) for a detailed discussion of this.
[19] Interview, consultant, June 2017.
[20] Interview, mid-range bank, June 2017.
[21] Interview, BNR official, June 2017.

signalling adherence to global financial standards is observable across most countries. Similarly, in Rwanda, there are reasons to question the validity of data presented by BNR in annual reports with regards to price and financial stability, as there are in relation to growth and poverty (Ansoms et al., 2017).[22] Particularly striking is the observable decrease in inflation, despite the consistent reporting of drought in those years. In the following sections, the paper discusses how BNR has successfully presented itself as an effective organisation through presenting success in maintaining price and financial stability.

Politics of price stability

Inflation targeting (IT) has become a key component of the new orthodoxy of mainstream macroeconomics. Epstein and Yeldan (2009) refer to 'inflation targeting' as the 'sacred cow' of central banking. Prior to 1994, the preceding Juvenal Habyarimana government had managed to keep inflation at a low level in the 1980s, at an average rate of 4.7 percent – until, of course, inflation increased rapidly in the late 1980s and early 1990s. Initially adopted in New Zealand in 1990, IT monetary frameworks have quickly gained traction around the world, with IFIs increasingly involved in offering advice on how to adopt inflation targeting as their operating framework. IT policies have reportedly been associated with some positive effects, including consumer prices being less prone to shocks and exchange rate pass-through effects reduced (Mishkin and Schmidt-Hebbel, 2001). However, others report that inflation targeting has not yielded reduced inflation below the levels attained by countries using other monetary regimes (Epstein and Yeldan, 2009). IT proponents have tended to argue that inflation should be as low as possible and that such policies (assumed to be appropriate for advanced countries) have similar applicability in non-industrialised countries. However, others (Pollin and Zhu, 2006) show that inflation of up to 15-18 percent can be associated with moderate gains in GDP. For a more comprehensive criticism of the arguments of the New Monetary Policy Consensus, which includes both IT and CBI, see Saad-Filho (2007).

IT, as a formal monetary policy regime, involves the declaration of an inflation target by the central bank. The central bank then uses monetary tools – often a policy interest rate – to keep inflation within the targeted range (Heintz and Ndikumana, 2011). IT proponents argue that this creates accountability for the central bank, but critics (Epstein and Yeldan, 2009) argue that this form of accountability is undemocratic, since it requires accountability to external actors, rather than to the population. In reality, inflation is not entirely under the control of central banks in developing countries, because of shifts in the global economy (commodity price fluctuations), domestic price volatility (through changes in climatic conditions for agriculture and political changes) or unexpected changes in the macroeconomic environment. Conscious of difficulties in controlling the prices of commodities outside their control, the BNR has recorded underlying inflation statistics since 2003, 'which excludes volatile prices' like food products and fuel. Since the 2000s, underlying inflation has broadly experienced reduction and stability, with BNR reports arguing

[22] See articles in the Review of African Political Economy blog.

that this rate is a better indicator of central bank monetary policy.[23] Recording these statistics is a way in which BNR signals alignment with the monetary policy objectives of the IFIs, highlighting how the activities of its central bank adhere to global objectives, although overall inflation may not be entirely under the bank's control.

BNR has officially remained committed to recording low inflation since the 1990s. In 1998, the IMF and World Bank advised BNR to consider an extremely conservative medium-term inflation target of 3 percent a year (Sayinzoga and Simson, 2006). Though this was not adopted, in the late 2000s, the government began to informally target single-digit inflation. The BNR Act 2007 highlights the primary objective of monetary policy as price stability in line with conventional market-led objectives. Figure 2 illustrates the evolution of annual inflation in Rwanda, showcasing effectiveness in reducing inflation. BNR has been committed to eventually embracing a price-based approach to monetary policy in the long term. Annual reports and official BNR documents consistently cite the importance of prioritising low inflation. Government reports (including BNR documents) consistently mention that inflation has been managed successfully. Rutayisire (a BNR employee) mentions that between 1996 and 2008, inflation was controlled at a level of 5.4 percent (Rutayisire, 2010). During the 2001-2005 period, inflation was at an average rate of 5 percent (ibid). These averages mask the significant price volatility cited in annual reports. Inflation actually spiked in 2003, directly as a result of 'considerable monetary expansion', with money supply increasing at a rate of 16.1 percent, compared to 9.2 percent envisaged in the monetary programme for the year (BNR, 2004: 6). In the early 2000s, BNR reports maintained that there were difficulties controlling inflation, because of an increase in consumer prices for foodstuffs like cassava flour, rice, Irish potatoes and maize.

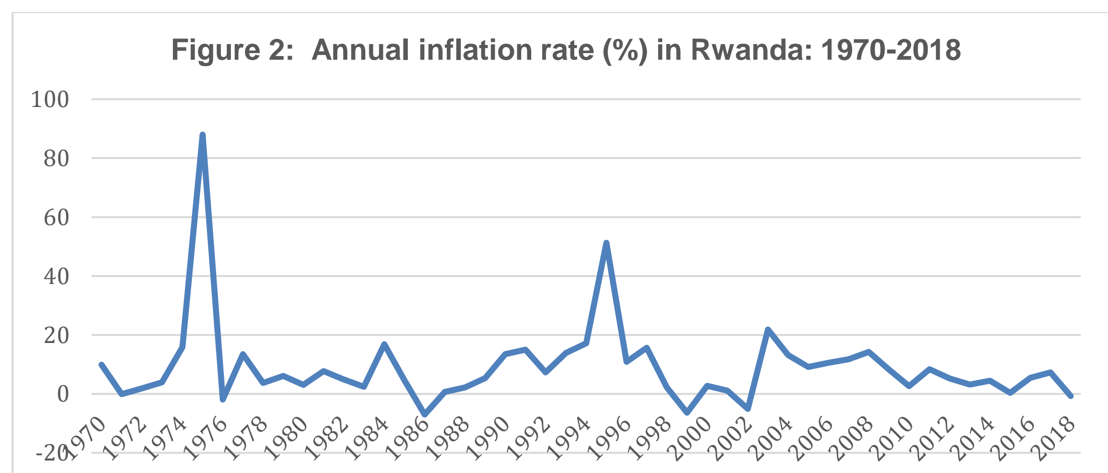

Figure 2: Annual inflation rate (%) in Rwanda: 1970-2018

Source: BNR.[24]

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[23] This has not always been the case. In 2006, for example, underlying inflation increased, with an increase in school fees, as well as housing, water, gas, electricity and transport prices (BNR, 2007).

[24] These are averages for inflation for the entire year. The statistics thus mask the volatility in prices within the country over the course of the year.

One World Bank (2013) document highlights that the average rate of inflation in Rwanda over the last decade has been lower than other East African countries, but above average in Sub-Saharan Africa. Yet the narrative of 'low inflation' continues to be a central feature of BNR's public pronouncements over the last two decades. For example, chief economist Kigabo suggests that

> 'the development of the money market in 1997 and low inflation rates have allowed BNR to progressively reduce the reserve requirement ratio since May 1995 to 12 percent in 1997, 10 percent in 1998, 8 percent in 2000 and 5 percent since the first quarter of 2009'.

BNR's goals of presenting the organisation as a good student of the IFIs have highlighted the distance between the theory and practice of inflation targeting. Though inflation has reduced over time, it has not consistently reduced (as per the government's narrative). To mark its alignment with IT frameworks further, the BNR officially moved from a quantity-based monetary policy framework to a price-based approach. Officially, BNR aims to keep inflation low, stable and predictable (around 5 percent or between 2 and 8 percent).

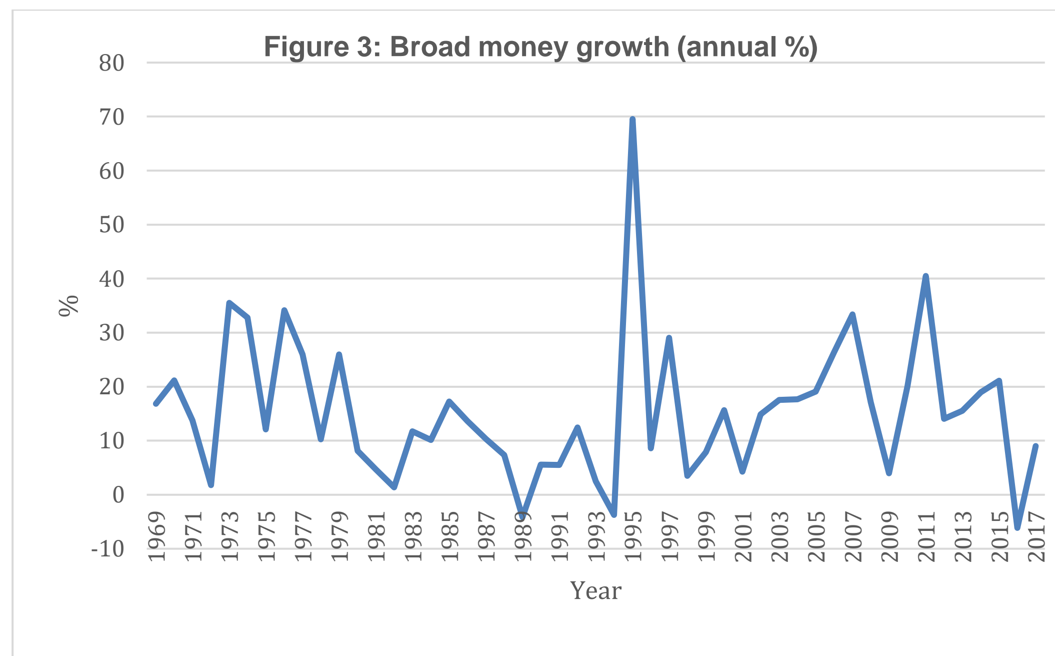
Scholarship highlights two ways in which BNR attempts to control the inflation rate. Like most other countries (as a result of pressure from IFIs and structural adjustment programmes), Rwanda shifted from direct to indirect monetary policy in November 1990. The civil war and genocide slowed these reforms. However, since 1995, the RPF government committed to developing monetary policy through market-based mechanisms, coupled with financial sector liberalisation and market-led reforms across the economy. Three key donor programmes have shaped Rwanda's evolution to a market-based economy: the 1990 Structural Adjustment Programme, the Poverty Reduction and Growth Facility (1998) and the 2013 Policy Support Instrument (PSI), which has been implemented by the government with support from the IMF and the World Bank (Irankunda, 2014).

As part of committing to market-led reforms, the Rwandan government removed direct credit controls in 1992 and interest rates were fully liberalised in 1996. The exchange rate system was initially reformed through the 1990 structural adjustment programme, with residents authorised to hold accounts in foreign currencies in commercial banks. In 1995, the flexible exchange rate system was introduced (Irankunda, 2014). The capital account was fully liberalised in 2009 (Kigabo, 2018). Rwanda's monetary policy is administered under a monetary targeting regime. Broad money (M3) is used as an intermediate target for regulating the money supply and reserve money.

Figure 3 details the evolution of broad money growth. The money market began to be prioritised in 1997, as part of attempts to control inflation rates. Figure 2 illustrates the evolution of broad money in Rwanda, which has increased (apart from a negative dip in 2016 and very low growth in 2009). The low growth in the money market in 2009 is explained by a liquidity crunch experienced in Rwanda's banking sector in mid-2008.

The RSSB's large investments in different projects and the global financial crisis are perceived to have been causes of this crisis (Kigabo and Gichondo, 2018). The aggressive use of the RSSB was motivated by the reduced reliance on domestic capital for strategic investments, thus showing how political frictions had not only motivated liberalisation, but restricted use of policy instruments available to the government for strategic investments. Domestic commercial banks were forced to use lender-of-last resort facilities for the first time (ibid). Kigabo and Gichondo (2018) cite several policy responses including (a) a reduction in the reserve requirements from 8 percent to 5 percent in February 2009; (b) introduction of a 3-12 month BNR liquidity facility, with T-bills not rolled over at their maturities; (c) a 22.4 billion Rwf long-term government facility given to seven banks to increase their capacities to finance projects. Gradually, these policies worked to increase deposits of commercial banks from 366.6 billion Rwf in March 2009 to 783.1 billion Rwf in December 2012.

Changes in central bank leadership have not resulted in substantial shifts in government policies. Though this may indicate some degree of consistency, BNR's autonomy is questionable, given that 'policy priorities are approved at the top', with



Source: World Development Indicators.

'the top' existing outside the BNR and presumably in the presidency.[25] Although the BNR may be autonomous from broader societal pressures, the president appoints the governor. The president also retains the power to hire and fire governors. The result has been that financial sector priorities have been contradictory, since the Rwandan government 'wants to be all things to everyone.'[26] As one consultant pointed out, 'senior regulators have to deliver on the agenda decided by leadership and leadership wants success on all fronts. But not all these successes can be

[25] Interview, senior BNR regulator, June 2017.

[26] Interview, foreign financial sector consultant, June 2017.

achieved simultaneously.'[27] The bulk of BNR activity has been dedicated to securing against risk, with limited attention to perceiving how the banking sector could be used to support economic transformation goals. There is also ideological consensus to reform the financial sector along neoliberal lines, with central bank governors – in alliance with IFIs – gradually paving the way for the adoption of an IT framework for monetary policy

Politics of financial stability

The BNR defines financial stability as a condition when the financial system (institutions, markets and infrastructures) is able to provide financial products and services to economic agents in a sustainable manner at all times, including when faced with shocks.[28]

BNR officials have maintained that financial stability and attempts to 'secure against risk' have been the primary goals of the organisation. Though formally, there was less attention to IFI recommendations until the 2000s, BNR has gradually reformed legislation in line with harmonising its policies with other EAC countries and aligning with 'best practice' financial standards like Basel II and III. This suggests an ideological alignment of central bank governments (over the last two decades) with IFI advice. However, the strategies through which BNR has successfully achieved financial stability have been motivated by existing political dynamics in the country.

After the 1994 genocide, the financial sector was in severe difficulties, with the fleeing members of the previous government even stealing over 30 billion francs, or two-thirds of the monetary base, including cash from the vaults of the National Bank of Rwanda (BNR), the central regulatory agency (Addison et al., 2001). Official BNR reports (BNR, 2011) highlighted the 'direct control' of the financial system as a hindrance to growth. Direct control of credit was removed in 1992 and interest rates were fully liberalised in 1996. IMF and World Bank influence was clear in the sector. Liberalisation of the financial sector and the introduction of a flexible exchange rate system were introduced in the context of three economic stabilisation programmes, pushed through by the IMF and the World Bank – the Structural Adjustment Programme (1990), the Enhanced Structural Adjustment Facility-Poverty Reduction and Growth Facility (1998) and the Policy Support Instrument (2010). Particularly after 2002, there has been increasing focus on developing BNR regulation along the lines of global banking standards and donor advice.

In 1999, the Banking Supervision Department was created within BNR, with the aim of streamlining and ensuring an efficient banking sector. The BNR Law of 1981 was revised by the Banks Act of 1999, with BNR issuing several prudential regulations. The regulatory level of commercial banks share capital went up progressively, from Rwf 100 Million to Rwf 300 million in 1995, to Rwf 1.5 billion in1999 and to Rwf 5 billion in 2006. To enable the central bank to focus on high-risk banks and high-risk

[27] Interview, foreign financial sector consultant, November 2018.
[28] BNR (2019b).

areas in each bank, BNR adopted the Risk Based Supervision (RBS) framework from 2006. Adoption of RBS was to ensure compliance with and implementation of international best practices. In 1999, the Rwanda Central Banking Act was revised to grant BNR independence to formulate and implement monetary policy and ensure financial stability. The 1999 Act was 'strengthened to enhance regulatory frameworks, reduce regulatory forbearance, ensure market discipline and comply with the Basel principles of effective supervision' (Rusagara 2008: 3). In 2003, IFRS-based accounting standards were introduced for the banking sector. In the same year, solvency ratios were increased from 8 to 10 percent, the decrease of permissible deduction of accepted collateral from loan-loss provisions from 100 to 70 percent, and the strengthening of rules on insider lending, loan management, credit concentration and the restructuring of the banking sector. Since then, a 2007 BNR Law and a 2008 Law on the Organization of Banking (LOB) have further strengthened the BNR's regulatory authority. Since the 2008 LOB was enacted, BNR dedicated time to ensuring all new regulations aligned with the law. During this period, several new banks entered the sector. As a result, new commercial banks hired several BNR officials. The extent of regulation became less of a problem compared to the limited capabilities of recently hired supervisors.[29] 'Once, they were trained to a high level, they left and this continues to happen.'[30]

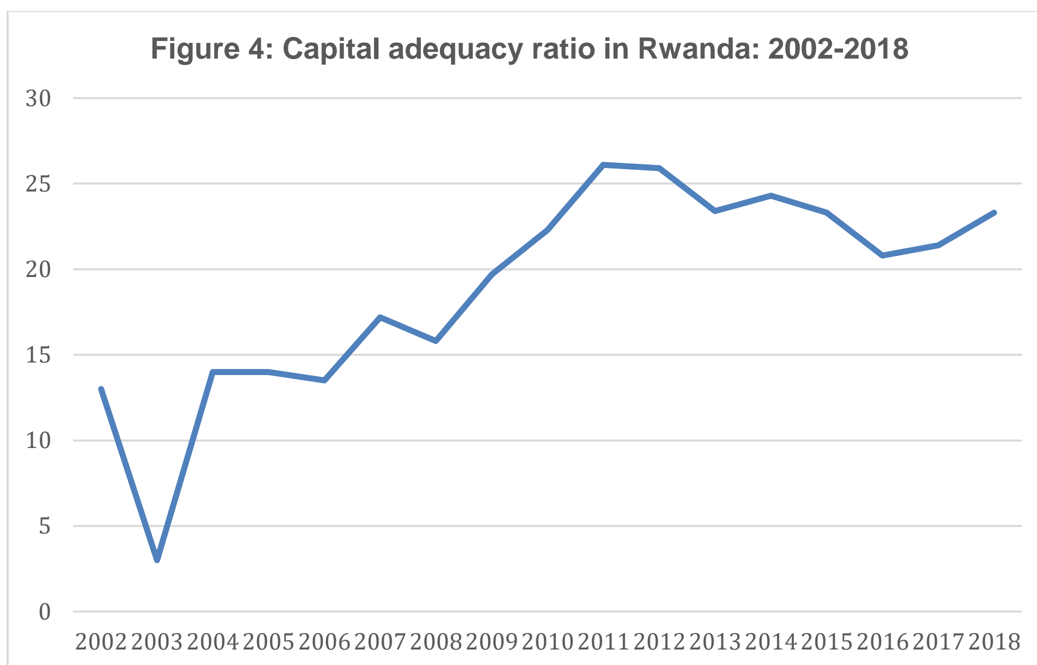
Alongside publishing annual reports on financial stability since 2008, the Rwandan government has also published two Financial Sector Development Program (FSDP) Strategies, which have been direct responses to two IMF Financial System Stability Assessment (FSAP) reports. After FSAP-1 in 2005, the government developed a strategic plan (2008-2012) under FSDP-1. The FSAP-1 (IMF, 2005) recommended that the government take several actions to improve compliance with Basel core principles (BCPs). IMF (2005) highlighted several weaknesses in relation to enforcement, the limited BNR staff, amending the solvency ratio, strengthening regulations on lending, and harmonising auditing and accounting standards at international levels. In 2007-08, Rwanda's banking sector suffered a crisis, forcing BNR to redesign its prudential regulations on liquidity risk management (Sanya, Mitchell and Kantengwa, 2012). BNR regulators highlight that during this period, there was a 'liquidity crunch'.[31] This liquidity crisis continued till at least 2010, occurring at a time when several new banks began operations in Rwanda. BNR's banking supervision team 'lost all of their staff', further highlighting the skills shortage within the financial sector.[32] Losing staff has been a consistent challenge for BNR over the two last decades. BNR is then forced to re-train staff, with the support of IFIs.

After FSAP-2 was conducted, FSDP-2 developed a roadmap between 2014 and 2018, while also identifying 437 policy actions. FSAP-2 (IMF, 2011) highlighted that Rwanda's capital adequacy requirements conform to Basel I principles. Though the

[29] Interview, commercial bank risk manager, June 2017.
[30] Interview, BNR official, June 2017.
[31] Interview, BNR official, June 2017.
[32] Interviews, Rwandan risk managers (government and commercial), June 2017.

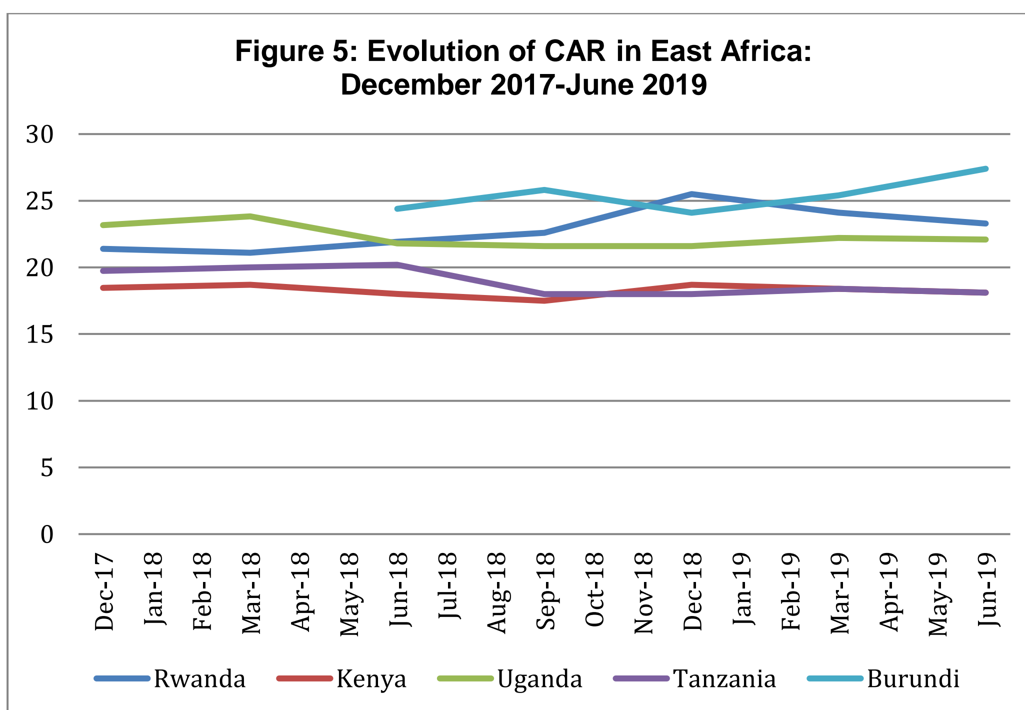
minimum capital adequacy requirement is 15 per cent in Rwanda, the BNR did not apply a capital adequacy charge for market risk (as of 2011). The IMF (2011) also found several weaknesses in Rwanda's banking sector reforms, including the need to speed up the process of introducing prudential regulation on the basis for new laws, strengthening the framework for cross-border supervisory cooperation, increasing the frequency of on-site examinations for the largest banks and ensuring BNR staff remained updated with the skills and supervisory methods expected of them in relation to new laws and regulations. After FSAP-2, BNR initiated new requirements in banking supervision within commercial banks, calling for the establishment of separate risk departments. This was a big challenge for skills, as there were few bankers within Rwanda with such expertise. In 2012, across the financial sector, the National Skills Survey found that 'the financial services sector has a total skills gap of 6,312 labour units (or employees)' (RDB, 2012).

Until recently, the Rwandan government was relatively slow with officially emphasising a strategy to comply with BCPs or Basel II and III banking standards. However, unofficially, a decision was taken to adopt Basel standards during Kanimba's stint as governor. This was also partly driven by an EAC decision in the mid-2000s to develop a common position in relation to Basel standards. Since then, the government has stated its desire to become fully compliant with all 25 BCPs. The decision to adopt and implement Basel II and III was taken after the FSAP-2 was published. At least, in terms of capital adequacy requirements, the average among commercial banks operated above Basel 1 requirements. Figure 4 details the very high rates of capital adequacy in the country, which has been formally above Basel requirements for several years. Figure 5 shows that Rwanda now has the highest capital adequacy ratio (CAR) in the region, with the exception of Burundi. The CAR in commercial banks stood at 13.7 percent in 2006, 16.2 percent in 2007 and 15.9 percent in 2008 (BNR 2009). After 2010, Rwanda's CAR has stayed in excess of 20 percent and has been the highest in the region. In 2011, BNR required banks to hold core capital of at least 10 percent of risk-weighted assets and total capital (core plus supplementary capital) of at least 15 percent of risk-weighted assets. In 2016, several banking standards were above Basel II/III thresholds. For example, the leverage ratio in Rwanda increased at a rate of 1 percent annually between 2014 and 2016 – from 8 percent to 10 percent, which was significantly above Basel II/III thresholds (3 percent) and above BNR requirements (6 percent). The key differences were the introduction of risk-weighting based on the external credit rating of the counterparty. But it was estimated that this would have 'minimal effect, due to virtual absence of rated counterparties to the Rwandan banking system' (Andrews et al., 2012: 66).



Source: BNR.

BNR has established a financial stability committee and directorate to monitor continued progress in its financial stability indicators and in the implementation of best practice standards like Basel II and III. In 2013, a Basel steering committee was established, which included BNR officials and three commercial bank risk managers (who were the most senior Rwandan regulators and had previously worked in BNR).



Source: BNR (2019b).

Most decisions with regard to Basel II and III implementation have been taken while engaging with this committee, although all commercial banks have been invited to take part in the consultation process. Though commercial bank representatives agreed that there was consultation, they complained that discussions were 'never reflected in the final document.'[33] However, the decision to implement Basel II and III was taken as part of the government's development strategy, with government officials perceiving it to be central to the country's strategy of becoming a financial sector hub. A few regulators (though not a majority) even argued that Basel implementation had clear links to creating a better business environment.[34] The rapid adoption of Basel standards has been criticised by consultants, commercial banks and even the IFIs. A senior BNR regulator admitted that there 'will be complications and some of it, we will figure it out as we go along'.[35] A commercial banker echoed the BNR regulator's observation, by saying 'the approach here seems to be: "let's go for it and address issues later"'.[36] This implement first and adapt later attitude showcases the prioritisation of external signalling ahead of the needs of the domestic economy.

Prioritising external signaling makes it impossible to support patient long-term lending within the commercial banking sector. This is most evident through the methods used to successfully reduce non-performing loans since the early 2000s. See Figure 6 for an illustration of the evolution of non-performing loans in Rwanda.

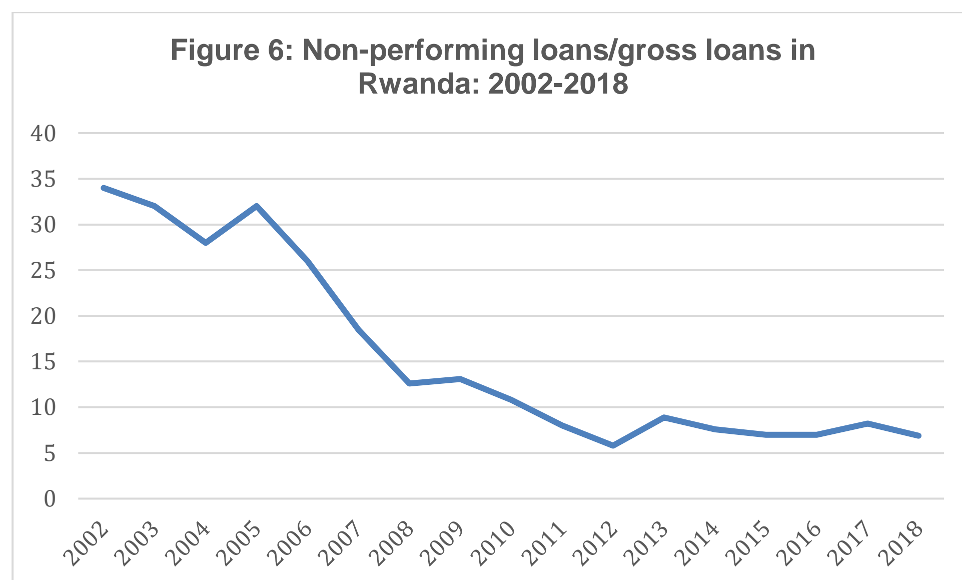


Figure 6: Non-performing loans/gross loans in Rwanda: 2002-2018

As mentioned earlier, in the 1990s, external consultants cited financial irregularities in the loan portfolios of banks, including BACAR, BCR and BDI. Private Rwandan citizens – initially close to the RPF – had shares in these banks. These financial irregularities created an opportunity for RPF leadership to use the 'combat against

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[33] Interview, large bank, June 2017.
[34] Interview, BNR, June 2017.
[35] Interview, BNR official, June 2017.
[36] Interview, small bank, June 2107.

corruption' to marginalise certain RPF figures. Additionally, the RPF's methods in ensuring loanees paid back funds underlined the control the party maintained within society. In the early 2000s, one of BNR's main responsibilities was the recovery of NPLs. Public shaming methods were used, by publishing the names of all debtors whose case was before court (BNR, 2005).[37] Debtors were also refused access to future loans until they paid back existing loans. BNR (2005, 2006) attributes some of the success in reducing NPLs to such methods.

These instances also show the government's prioritisation of avoiding bank closures. BNR has considered bank closures 'a weak signal for our financial sector' and favoured restructuring banks ahead of closing them down.[38] Thus, the lack of bank closures should not be understood as a sign of high performance within the sector. Some banks continue to have high NPLs and have been on the verge of collapse for over a decade (BPR). But the government has chosen to restructure banks, rather than try to close them, as this may act as a signal of unhealthy financial sector externally. BNR's goals of externally signalling a sound financial sector have determined the regulatory choices of government officials. Though NPLs have reduced dramatically sector-wide over the years, many banks continue to remain in financial difficulties. A focus on averages allows the portrayal of financial stability, but obscures the politics under the surface.

Conclusion: Prospects for development effectiveness?

During the first UK-Africa Investment Summit in January 2020, the World Bank listed the inaugural bond in Rwandan Franc, rated AAA, in the London Stock Exchange. The World Bank will raise 37 billion Rwandan Franc (40 million USD), which will be invested in a matching Rwandan Franc government bond issuance to finance infrastructural projects during the financial year 2019-2020. This is the seventh bond that the World Bank has issued in Sub-Saharan Africa and directly mentions the intention of growing capital markets in the country (Namata, 2020). Goals of enhancing the Rwanda Stock Exchange are in line with the country's aims of becoming a financial sector hub, which has been highlighted as a key priority in the country's economic strategy, NST 1 (2017-204). In reality, there has been limited progress in encouraging stock market transactions (with only seven companies listed on the bourse). Interestingly, in 2019, directly as a result of implementing procedures in line with Basel reforms, majority government-owned Bank of Kigali (BK) listed additional shares on the Nairobi Securities Exchange, which meant that BK was likely to reduce government ownership. These two examples directly show how BNR's goals of aligning its reforms in line with conventional IFI wisdom are inhibiting state involvement in the economy and the space for directed investments for structural transformation.

[37] Similar methods have been cited across other sectors in Rwanda (Booth and Golooba-Mutebi, 2014).
[38] Interview, senior BNR official, June 2018.

This paper has discussed how BNR's alignment with global financial standards was initially motivated by domestic political frictions within the ruling party. The choice to liberalise and reform the financial sector along neoliberal lines appeared a convenient choice, given that the threat was posed by reliance on domestic elites. Arguably, requirements to reform financial sector policies have forced an increasing cognitive alignment with what IFIs see as 'best practice' reforms for developing countries. Thus, there is a growing distance between the political space for developmentalist banking and the need to align with IFI practices.

The successful portrayal of central bank effectiveness has played important roles. It has presented the achievement of neoliberal 'best practice' and satisfied IFIs with the government's desire for such reforms. It has also reduced reliance on domestic capital and domestic sources more generally, with performance judged solely on restricted quantitative measures and averages, assumed to be best practice by IFIs. More worrying is that the government's desire for global financial integration may reduce developmentalist possibilities further. The government's distrust of domestic capital reduces options for partners with which it can strategically invest for structural transformation.

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Annex 1

Details and ownership of Rwandan commercial banks (June 2017)

Year of establishment	Name of bank	Ownership
1963	I&M Bank Rwanda (formerly BCR)	55% (I&M Bank); 12.5% (PROPARCO); 12.5% (German Investment Corporation); 19.8% (Rwandan government); 0.2% (others)
1966	Bank of Kigali (BK)	29.5% (Rwandan government); 25.1% (Rwanda Social Security Board); 16.6% (international institutional investors); 11.2% (retail investors); 8.9% (local institutional investors); 7.6% (regional institutional investors); 0.9% (employees and directors); 0.1% (other state-owned entities)
1975	*Banque Populaire du Rwanda* SA (part of Atlas Mara) – also acquired The Development Bank of Rwanda's (BRD) Commercial Bank in 2014	62.1% (Atlas Mara Mauritius Ltd.); 23.3% (local shareholders); 14.6% (Rabobank)
1999	*Compagnie Générale de Banque* (Cogebanque)	60% (COGEAR); 40% (Shorecap International, AfricaInvest and Belgian Investment Company for Developing

		countries)
2004	Guaranty Trust Bank Rwanda	95.73% (GT Bank); 4.27% (Rwandan government)
2007	Ecobank Rwanda (buying BACAR in 2007)	100% (EcoBank)
2008	Kenya Commercial Bank (KCB)	100% (KCB Group)
2009	Access Bank Rwanda (bought BANCOR)	75% (Access Bank Group); 25% (Rwandan and South African investors)
2011	Equity Bank Rwanda (formerly BACAR and Fina Bank)	100% (Equity Group Holdings Ltd.)
2014	Crane Bank Rwanda	100% (Commercial Bank of Africa)
2015	Bank of Africa Rwanda Ltd. (formerly Agaseke bank)	90% (Bank of Africa Group); 10% (other retail investors)

A major challenge for achieving poverty reduction is that the capacity of states to deliver development is in short supply, particularly in Africa.

However, 'pockets of effectiveness' (PoEs) offer important clues concerning how developmental forms of state capacity might emerge and be sustained in difficult contexts.

Pockets of effectiveness (PoEs) are public organisations that function effectively in providing public goods and services, despite operating in an environment where effective public service delivery is not the norm. Recent research on PoEs has suggested that both external (e.g. political context) and internal factors (e.g. organisational leadership) shape their performance. However, this emerging subfield of governance research lacks a comparative study which systematically identifies how PoEs emerge and are sustained in different contexts and sectors, and the role that domestic and international actors can play in this. Specifically, we are seeking to understand the political and bureaucratic logics that shape the emergence and performance of PoEs. Our research questions are:

How do pockets of effectiveness emerge and how are they sustained within different types of context and sector?
What role has been and could be played by domestic and international actors in support of this?

Pockets of effectiveness (PoEs) are public organisations that function effectively in providing public goods and services, despite operating in an environment where effective public service delivery is not the norm. This project, which investigates PoEs in relation to the politics of state-building and regime survival in sub-Saharan Africa, is being led by Professor Sam Hickey, based at the Global Development Institute, The University of Manchester, in collaboration with Professor Giles Mohan (The Open University), Dr Abdul-Gafaru Abdulai (University of Ghana), Dr Badru Bukenya (Makerere University), Dr Benjamin Chemouni (University of Cambridge), Dr Marja Hinfelaar (SAIPAR, Lusaka) and Dr Matt Tyce (GDI, The University Manchester). It is funded by the Economic and Social Research Council and Department for International Development with some additional funding from the DFID-funded Effective States and Inclusive Development Research Centre.
http://www.effective-states.org/research/pockets-of-effectiveness/