

The PRGF and Fiscal Space in Rwanda



African Forum and Network
on Debt and Development

A Research Commissioned by AFRODAD

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AFRODAD aspires for an equitable and sustainable development process leading to a prosperous Africa.

AFRODAD Mission

To secure policies that will redress the African debt crisis based on a human rights value system.

AFRODAD Objectives include the following:

- 1 To enhance efficient and effective management and use of resources by African governments;
- 2 To secure a paradigm shift in the international socio-economic and political world order to a development process that addresses the needs and aspirations of the majority of the people in the world.
- 3 To facilitate dialogue between civil society and governments on issues related to Debt and development in Africa and elsewhere.

From the vision and the mission statements and from our objectives, it is clear that the Debt crisis, apart from being a political, economic and structural issue, has an intrinsic link to human rights. This forms the guiding philosophy for our work on Debt and the need to have African external debts cancelled for poverty eradication and attainment of social and economic justice. Furthermore, the principle of equity must of necessity apply and in this regard, responsibility of creditors and debtors in the debt crisis should be acknowledged and assumed by the parties. When this is not done, it is a reflection of failure of governance mechanisms at the global level that protect the interests of the weaker nations. The Transparent Arbitration mechanism proposed by AFRODAD as one way of dealing with the debt crisis finds a fundamental basis in this respect.

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Preface

The impact of fiscal space on growth and achievement of the internationally agreed development goals has featured prominently on the research agenda of government development agencies, international financial institutions, and civil society organizations. The Poverty Reduction Growth Facility (PRGF) has remained topical in the discussions around the quest by countries in the South to regain control of their own fiscal space from the International financial institutions. The controversy over IMF policies especially the PRGF boils down to a difference of opinion over how and when governments should be allowed to invest in both infrastructure and basic services. The IFIs, CSOs and the UN Development Programme (UNDP) have contrasting views on how to increase fiscal space, that is, on how to enable governments to spend and invest more. In their definition of fiscal space, the UNDP stresses the quality of public expenditure since productive expenditures will foster growth and human development, a larger 'budget pie', and more fiscal space in the long-term. On the other hand, Scholars, policy-makers and activists have focused on how to mobilize resources, or create the 'space' in national budgets, to invest in achieving the internationally agreed development goals, including the MDGs.

In efforts to recover from economic crises, most countries in sub-Saharan Africa began implementing IMF- and World Bank-led structural adjustment programmes during the 1980s. Those programmes promoted policies to expand the role of the market and reduce that of the state in economic affairs. They curtailed public spending for education and health care, privatized state-owned enterprises and liberalized trade. African governments had to cede control over their economic decision-making in order to qualify for World Bank and IMF loans. The PRGF and the succeeding Policy Support Instrument (PSI, introduced in 2005) have been nothing less than a continuation of such policies but under the guise of a new framework. The policies contained in both PRGF and PSI remains consistent with the standard IMF austerity programmes that have proved deeply controversial over the last 25 years. The only difference is that the IMF through such instruments is seeking to polish up its appalling image of being a tough lender and disciplinarian in Sub-Saharan Africa. This study constitutes one of the several PRGF researches that AFRODAD commissioned as part of its contribution to the civic call for the IMF to free policy space and enable African governments to pursue economic resuscitation of their battered economies after many years of the ill-conceived structural adjustment programs.

This study discusses the PRGF and the question of fiscal space as perceived by the citizens who are affected by IMF policy instruments. Conditions are one of the most controversial aspects of IMF and World Bank lending. Critics often claim that the institutions do not pay adequate attention to how the conditions affect people's lives or the contradictory ways in which multiple conditions interact with each other. Many governments also say that the conditions prevent them from making decisions which should rightly be made by elected leaders and that they also fail to address the basic problems that hinder economic development. The study concludes by giving recommendations to both the Fund and the government(s) on how to deal with the question of fiscal space.



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TABLE OF CONTENTS

EXECUTIVE SUMMARY	8
1.0 INTRODUCTION	10
1.1 Debt Relief	11
1.2 Background on Rwanda	11
1.3 Statement of the Problem	12
2.0 RWANDA'S RELATIONSHIP with the IMF	14
2.1 A Brief Historical Account	14
2.2 The 2005 PRGF Arrangement	16
2.3 Outcomes of PRGF Reviews	18
2.4 Indication of the Cost of the Reforms	19
3.0 THE PRGF and RWANDA'S DEVELOPMENT PROGRAMME	20
3.1 Main Tenets of Rwanda's Development Strategy	20
3.2 The Linkages between the PRGF and Rwanda's PRSP	21
3.3 Financing the EDPRS	22
3.4 Programmes to which PRGF Funds Directed	25
3.5 Impact of IMF's Signalling Role on Aid Disbursements	26
4.0 THE PRGF and FISCAL SPACE	27
4.1 Impact of the PRGF on the National Budget and MTEF	28
4.2 Impacts of PRGF Structural Benchmarks and Quantitative Conditions on Fiscal Space	30
4.3 Fiscal Space: Has it Increased or Decreased?	32
5.0 CONCLUSIONS	34
LIST OF TABLES AND FIGURES	
Table 1.1 Rwanda: Selected Social Indicators	11
Table 2.1 Rwanda: Relation with IMF, as of April 30, 2007	14
Table 2.2 Rwanda: Latest Financial Arrangements	14
Table 2.3 Rwanda: Implementation of HIPC initiative	15
Table 2.4 Rwanda: Implementation of MDRI assistance	15
Table 2.5 Fiscal program in 2005	17
Box 1: Underlying Principles of the Rwanda EDPRS Process	20
Figure 3.1 Rwanda: Link between PRGF and PRSP	21
Table 3.1 Rwanda: EDPRS costs	22
Table 3.2 Rwanda: Sector Allocation Costs	23
Table 3.3 Rwanda: EDPRS Financing	24
Table 3.4 Rwanda: Priority activities identified in the PRSP	25
Figure 3.2 Evolution of grants	26
Table 4.1 Rwanda Public Finance	29
Chart 4.1 Rwanda Budget Deficit	29
Table 4.2 Rwanda: Sectoral Allocations of Recurrent Public Expenditure	30
Table 4.3 Rwanda: Absorption and Spending of Aid	31
Table 4.4 Absorption and spending of aid: African comparisons	32
Table 4.5 Rwanda: Fiscal program 2006-2007	33

LIST OF ABBREVIATIONS

AIDS	Acquired Immune Deficiency Syndrome
EDPRS	Economic Development and Poverty Reduction Strategy
FSAP	Financial Sector Assessment Program
FSDP	Financial Sector Development Plan
FTEI	Fast Track Education Initiative
HCI	Head count index
IDA	International Development Association
HIPC	Highly Indebted Poor Country
HIV	Human Immunodeficiency Virus
GDP	Gross Domestic Product
GRA	General Resources Account
ICT	Information, Communication and Technology
IDA	International Development Association
IMF	International Monetary Fund
JSAN	Joint Staff Assessment Notes
LIC	Low-income countries
MoF	Ministry of Finance
MDGs	Millennium Development Goals
MEFP	Memorandum of Economic and Financial Policies
MFI	Microfinance institutions
MTEF	Medium Term Expenditure Framework
NBR	National Bank of Rwanda
NFA	Net Foreign Assets
NPV	Net Present Value
OBL	Organic Budget Law
PCs	Performance criteria
PFM	Public Financial Management
PPC	Public Procurement Code
PRGF	Poverty Reduction and Growth Facility
PRSG	Poverty Reduction Support Grant
PRSC	Poverty Reduction Support Credit
PRSP	Poverty Reduction Strategy Paper
RIEPA	Rwanda Investment and Export Promotion Agency
RWF	Rwanda Franc
SDR	Special Drawing Rights
SSA	Sub-Saharan Africa
TVET	Technical and Vocational Education and Training
VAT	Value added tax
UNDP	United Nations Development Programme
USD	United States Dollar
WB	World Bank

EXECUTIVE SUMMARY

In September 1999, the objectives of the IMF's concessional lending were broadened to include an explicit focus on poverty reduction in the context of a growth oriented strategy. The IMF supported, along with the World Bank, strategies elaborated by Rwandese Authorities in a Poverty Reduction Strategy Paper (PRSP), which has been prepared with the participation of civil society (including the poor) and other development partners.

The study discusses the Poverty Reduction and Growth Facility (PRGF) introduced by the International Monetary Fund (IMF) in 1999 as to replace the so-called Enhanced Structural Adjustment Facility (ESAF) reflecting the new objectives and procedures. One of the key changes was the introduction of the Poverty Reduction Strategy Paper (PRSP) prepared by the borrowing country and to be agreed by the IMF and the World Bank. This important document acts as the foundation for both the Fund's new instrument and that the Bank, the Poverty Reduction Strategy Credit (PRSC).

The Impact of PRGF on Rwanda's Development

The Rwanda's PRGF is linked with the country's post conflict status. Following a programme from 1996-1998, the Rwandese authorities negotiated an ESAF with the IMF in June 1998. Economic performance in the years after the genocide has been broadly good. GDP has averaged 8%, although this has slowed in recent years and has been around 5.8% per annum making Rwanda one of the top performers in Africa and an example of successful post conflict reconstruction. Inflation dropped rapidly from around 109.5% in 1995 and has been consistently in the single digit since 1998 and actually stands at 9.1% at the end of 2007. Further, over the same period, exchange rate has been stable.

Rwanda, under the PRGF, has made progress in the years since genocide period. Led by agriculture, output rebounded from the collapse a decade ago. Macroeconomic stability has largely been achieved with inflation averaging in the single digits for the last 7 years and international reserves at comfortable levels. Implementation of policies strengthened considerably with monetary and fiscal policy remaining broadly on track. Output growth turned out somewhat lower than expected and inflation higher mainly because of exogenous shocks particularly in energy. However, exports rebounded and the current account narrowed, allowing net foreign assets to strengthen more than programmed.

The relatively broad-based conditionality that characterized the initial ESAF arrangements has been carried through to the PRGF. The current Facility is not only much more conditional than anticipated by the key features documents but quantitative performance criteria and benchmarks are somewhat more extensive and a list of structural conditions is longer and its scope wider than similar African countries. In the case of Rwanda, regarding quantitative performance, the criterion on priority spending was not met due to delay in a donor disbursement, when the Rwandese authorities chose to temporarily restrain spending (including on priorities) to maintain macroeconomic stability. With respect to structural performance, Rwanda substantively met the structural reform commitments.

Local commitment to the preparation of the PRSPs has been remarkable and extensive. The government has consulted widely with local civil society and donors as well as with IMF and the World Bank. The PRGF is certainly embedded in the Rwanda's PRSP and is, in principle, a key instrument with which to give substance to the general poverty reduction objectives as expressed in the PRSP.

The PRGF and Fiscal Space

Under PRGF arrangement, achieving Rwanda's development objectives as highlighted in the PRSP, required and will require strong mobilization of resources, beyond those currently identified. The planned expenditure path is driven by the government's assessment of forthcoming aid flows and would require hard-to-achieve spending prioritization, considering likely spillovers from the investment program, pressures on the wage bill, and increasing transfers to the provinces and districts. This underscores Rwanda's dependence on additional foreign grants.

Furthermore, the EDPRS does not project an increase in the revenue-to-GDP ratio; aiming for more ambitious revenue targets would be important to reduce Rwanda's dependence on aid over the long term.

The long-term debt sustainability warrants close monitoring. To complement current and projected donor commitments, the Government estimates an additional financing requirement. Additional borrowing would rapidly worsen the medium-term outlook for debt indicators. Thus, the debt sustainability analysis indicates that Rwanda remains at a high risk of debt distress. Therefore, the financing plan will require a significant scaling up of grant financing in order to ensure debt sustainability. Government efforts to develop a debt management strategy (embedded in a medium-term macro framework) are needed and the related institutions and processes. The Rwandese authorities are encouraged to accelerate implementation of their export promotion strategy to strengthen and diversify the export base.

The PRGF process has been accompanied by marked increase in flexibility. Specifically, the IMF is increasingly willing to accept a slower fiscal adjustment path if there is a clear case that there is demonstrable poverty reduction gain from higher expenditure. Rwanda has been able to draw on extensive support. Rwanda worked on developing a comprehensive MTEF and expenditure tracking systems is also ready.

1.0 INTRODUCTION

Since the 1960s, it has been suggested that external resources are needed to close the gap between the needs of development and domestically available financing. Maintaining sustained growth in Sub-Saharan Africa (SSA) is often cited as the most substantial challenge in global development. Foreign aid has been a factor in this context, as the continent's governments have come to depend on it.

This argument was originally framed in terms of the needs for physical investment to achieve given levels of economic growth, but is now more widely understood in terms of the need for public expenditure to achieve given targets of poverty reduction, as articulated by the Millennium Development Goals. Plausible calculations indicate that there is a need for significant increase in expenditures in order to achieve these development objectives and deal with crises such as the HIV/AIDS pandemic. For instance, estimates suggest that for low-income countries in Sub-Saharan Africa incremental funding needed for the health sector alone is on the order of 8.0% of Gross Domestic Product (GDP)¹.

Concerns about the macroeconomic impact of increased resource flows have led some observers to recommend that countries with large external and/or fiscal deficits, financed by grants and international borrowing, should aim to reduce them in the medium term rather than to mobilize additional external resources. These concerns have strong influence on the design of macroeconomic programmes under International Monetary Fund's (IMF) Heavily Indebted Poor Countries (HIPC) initiative and the Poverty Reduction and Growth Facility (PRGF). The idea behind it being that debt relief and the scaling up of aid to low-income countries, under certain structural conditions, should allow for greater fiscal space for expenditure programmes to create long-term growth and lower poverty rates.

1.1 Debt Relief

HIPC was first launched in 1996 following a sustained civil society campaign to reduce the debt burden in poor countries to sustainable levels through debt forgiveness. This is an IMF programme meant to ultimately result in debt relief, in order to increase the fiscal space of developing countries that had become constrained by exorbitant debt service payments. In 2005, G8 leaders decided to supplement the HIPC Initiative with the Multilateral Debt Relief Initiative (MDRI). The MDRI allows total cancellation of certain debts owed to the IMF, to International Development Association (IDA) of the World Bank and to African Development Fund (AfDB) for countries completing the HIPC Initiative process. In order to be considered for the HIPC Initiative, a country must be facing unsustainable external debt, has developed a Poverty Reduction Strategy Paper, be eligible for IDA and PRGF lending and demonstrated a good track record of reform under an IMF program².

In order to make the objectives of poverty and growth more central to lending operations among its poorest member countries, the IMF established the Poverty Reduction and Growth Facility (PRGF) in September 1999. In principle, eligibility for lending under PRGF is based on country's per capita income level. As of August 2006, 78 low-income countries were eligible, of which 50 countries had an active PRGF. The PRGF typically extends over a period of three years. The IMF missions assess macroeconomic situation, the borrower's adherence to conditions and benchmarks, negotiate conditions the next phase of program and entertain requests for waivers of conditions or extensions of the repayment period³. The PRGF is a prerequisite to graduation in the HIPC programme and the subsequent attainment of debt relief.

¹ See J.Sachs, letter to esteemed members of the Government of Uganda, Honourable, Ladies and Gentlemen: 17 May 2002 (HIID), and T. Dawson, The debate on aid flows to Uganda: the IMF's point of view, Eurodad PRS-watch, June, 2002 (available at www.imf.org).

² There are three phases to the HIPC initiative. The decision point corresponds to the confirmation of a country's eligibility by Executive Boards of the IMF and the World Bank. Once the country has qualified, it may start receiving Interim Relief, but it must continue to show improvement on key reforms included in the PRSP and agreed upon with the IMF and the IDA at Decision Point. Further, once the country has demonstrated satisfactory implementation of key reforms over a certain period of time (usually up to 3 years) it reaches Completion Point and becomes eligible to receive relief to the point of the sustainability target, see Paolo de Renzio, Mateo Bocci and Kristy Kamarck, 2006.

³ The reviews generally involve a large mission from IMF headquarter visiting the country for up to several weeks, see Paolo de Renzio, Mateo Bocci and Kristy Kamarck, 2006

1.2 Background on Rwanda

Rwanda, bordered by Burundi, Democratic Republic of Congo(DRC), Tanzania and Uganda, has 337 people per square kilometre, as compared to Kenya with 52, Senegal with 48, and DRC with 22 (World Development Indicators, 2006). From the 1980s, Rwanda suffered from a combination of high rates of population growth, (resulting in one of the highest rural population densities in Africa) declining agricultural productivity (in part, due to a decline in soil fertility), environmental degradation and decreasing per capital to GDP⁴.

In the aftermath of the genocide of 1994, Rwanda's social indicators deteriorated sharply. By 1997, 70.0% of the population lived below the poverty line (as defined in the 1985 household survey). The geographic and demographic profile of poverty has changed, with the loss of prime-age workers, the increase in female and minor-headed households. Most social indicators have worsened significantly since genocide (see table 1).

Table 1.1 Rwanda: Selected Social Indicators

Indicator	Rwanda 1988-93	Rwanda 1996-98	SSA 1996-98	HIPC 1998
GDP per capita (USD)	225	256	500	388
Poverty headcount index (percent)	53	70
Infant mortality (per 1,000 live births)	109	139	91	97
Maternal mortality (per 100,000)	300	810
Life expectancy (years)	47	42	51	52
Access to safe water (percent)	64	44	43	..
Illiteracy rate (percent of population 15+)	50	48	40	47
Female	63	55	54	57
Gross primary enrollment	71	88	78	..
Male	72	90 ¹	85	..
Female	70	87 ²	71	..

¹ Number of 1999

² Number of 1999

Sources: World Bank, Social Indicators of Development, 1995; Republic of Rwanda, Rwanda Development Indicators; and IMF.

The Rwandan economy has a very weak export base, with high dependence on agricultural exports, in particular tea and coffee and a resulting vulnerability to variability in world prices. The revenue base is very small and private investment levels are low.⁷ The Poverty Reduction Strategy Paper (PRSP) document stipulates that net small holds investment in agriculture may have been negative in the 1990s. Given that 90% of the population lives in the rural sector and this presents a huge challenge for the Rwandan economic governance. Also, the share of GDP from the various sectors of the Rwandan economy has not changed by much from 1996 to 2000 and from 2001 to 2006⁸: Agriculture: 37.7-36.4%; Industry: 15.1-14.2%; Services: 41.9-43.8%.

A great deal has been achieved since 1994, but Rwanda remains a poor country and is still recovering from the genocide. For instance, extra populations forward from 2002 household survey give head count ratios (population of people below the poverty line) of 48.0% in 1985, 68.0% in 2000 and 56.9% in 2006. The number was already rising before the genocide and shot up to over 80.0% immediately after the genocide. Despite the above poverty indicators, growth rates have averaged 5.8% per annum, making Rwanda one of the top performers in Africa and an example of successful post conflict reconstruction.

⁴ Daniel Clay et al., Promoting Food Security in Rwanda through sustainable Agricultural Productivity, office of sustainable Development, Bureau for Africa, Technical 28, USAID, 1996.

⁷ See draft PRSP, 2002; EDPRS, 2007

⁸ See EDPRS, 2007

This economic success has enabled significant progress in the fight against poverty, but that progress is still modest when taking into consideration the MDG targets.

In 1999, Rwanda's per capita GDP was estimated at USD 273 which is low even by sub-Saharan African standards. Rwanda had an unsustainable debt burden, with the NPV of debt estimated at about 520 percent of exports of goods and nonfactor services at end 1999; specifically US\$626 million. Fifty percent was owed to the World Bank Group, with an additional 9.7% and 16% to the IMF and the AfDB respectively.⁹

In May 2005, Rwanda became the 18th country to reach the completion point under the Highly Indebted Poor Countries Initiative (HIPC)¹⁰. Rwanda, as well as other countries, was eligible for debt relief, provided it fulfilled a number of criteria. Between 2003 and 2005, Rwanda underwent a number of reforms to ensure that the additional resources made available through the HIPC initiative would be well utilized and that debt levels would be maintained at sustainable levels afterwards.

Under the PRGF arrangement, Rwanda was subjected to two types of policy conditions. The first set of conditions was quantitative, such as ceilings on fiscal deficits¹¹, inflation or other macroeconomic targets. The second set of conditions was structural and encompasses reforms such as privatization, trade liberalization, private sector development, civil service reform, public expenditure management, poverty reduction, financial sector, agriculture sector, etc. These structural conditions, while not directly linked to the budget itself, can substantially influence, for example, the nature, level and composition of government revenues (for example, through the reduction of customs tariffs,) and expenditure (for example through the elimination of subsidies to state-owned enterprises).

1.3 Statement of the Problem

Developing countries, in particular low-income countries in Sub-Saharan Africa, frequently fall into poverty traps, with increasing poverty levels leading to increased borrowing, to increased indebtedness and hence even greater levels of poverty. This observation has led to large amounts of external aid being sought, as part of a big push (Sachs *et al.*, 2004). Adoption of the Millennium Development Goals (MDGs) can be seen in this context. A large injection of aid, used effectively, is meant to enable economic growth to get off the ground. However, this policy has received various criticisms (World Bank, Global Monitoring Report, 2005; Easterly, 2005). On the one hand, the very existence of poverty traps is contested. On the other hand, the ineffectiveness of aid is emphasised; e.g. no correlation between aid and investment; limited absorption capacity; ineffectiveness of aid in the absence of good policies; institutional weakness, etc.

The main objective of the project is to strengthen the links between debt relief and poverty reduction policies and to demonstrate their usefulness in understanding the fiscal and macroeconomic issues that will arise from an increase in aid flows to Rwanda. One of the requirements of HIPC is the Poverty Growth and Reduction Facility (PRGF), a lending arrangement of the International Monetary Fund (IMF), which is replete with structural reforms and quantitative conditions intended to improve the fiscal position of borrower governments so that more resources could be devoted to development programmes. In this context, the research aims to make an assessment as to whether the fiscal space created by the PRGF has indeed improved and contributed to the country's development strategy.

Specifically, the study seeks to

- Present the challenges and failures from the implementation of the PRGF;
- Establish how the PRGF has been underpinned within the national macroeconomic framework and establish how the programs have shaped the public expenditure framework;
- Establish the linkage between the program with various national instruments including National development plans/visions/strategies, Medium term expenditure framework, National Budget, and Sector allocations.

⁹ See Rwanda: Preliminary document on the Enhanced Initiative for Heavily Indebted Poor Countries Prepared by the Staffs of the International Development Association and the IMF, July 18, 2000

¹⁰ See Rwanda, UNDP Turning Vision 2020 into reality, 2007

¹¹ A fiscal (or budget) deficit occurs when a government's expenditures are higher than its revenues. It is generally expressed as a percentage of GDP.

The core methodology has been to review all documents associated with the Rwanda's PRGF arrangement, including Article IV consultations, reviews and memos, applications for waivers of conditionalities and IMF staff reports. Also, it was important to confine to the PRGF arrangement exclusively, concentrating on recent arrangements for the analysis required in all parts. Finally, relevant persons from the Rwanda's Ministry of Finance (MoF) and IMF Resident Mission to Rwanda have been orally interviewed.

This study will explore and discuss the fiscal space of Rwanda during these recent years. As the fiscal space is the total government activities, the focus will be the PRGF and the financing of development programmes in Rwanda.

In the fiscal space, there are a number of significant players which share the same properties of using resources for public purposes and function for some public purposes. Fiscal operations are identified with activities on the public sector agents in matters relating primarily to the provision of public goods and services. Section 2 of the study will mainly concentrate not only on the analysis of Rwanda's relationship with the International Monetary Fund but also will discuss some key points on the PRGF arrangement. Section 3 will focus on Rwanda's development strategy and how it has been financed. Section 4 will focus on the PRGF and Fiscal space. In addition, this section explores particularly the programmes to which PRGF funds have been directed. Section 5 draws the conclusions and key considerations and tries to assess whether the way Rwanda has used fiscal space generated by the PRGF as a lending facility has contributed to the achievement of the MDGs and the Rwanda Vision 2020.

2.0 RWANDA'S RELATIONSHIP with the IMF

IMF has a long history of engaging with policy reforms in developing countries, especially in Rwanda. Since many years, Rwanda's has had numerous interactions with the IMF, including reaching completion point under the HIPC Initiative in 2005, formulating two PRSPs and qualifying for three PRGF arrangements (1998, 2002, 2006). In Rwanda, IMF conditions, as laid out under PRGF framework, focus primarily on fiscal discipline and monetary stability.

2.1 A Brief Historical Account

The IMF played and continues to play a central role in the adjustment efforts of its member countries by assisting them in the design of appropriate adjustment programs to achieve viability of the balance of payments, price stability and sustained high growth and by providing financing to support these programs (see Khan and Haque, 2002). Therefore, a core responsibility of the IMF is to provide loans to countries experiencing balance of payments problems. This financial assistance enables countries to rebuild their international reserves, stabilize their currencies, and continue paying for imports and restore conditions for strong economic growth.

Rwanda joined the International Fund in 1963. Since 1998, the IMF has generally given financial assistance to Rwanda in the form of PRGF. Outstanding Fund credit was SDR 3.99 million (4.99% of quota) at end April 2007. Completion of the second review has allowed a disbursement of SDR 1.14 million.

Table 2.1 Rwanda: Relation with IMF, as of April 30, 2007

	SDR million	USD million	Percent quota
General resources account			
Quota	80.1	106.26	100.00
Fund holdings of currency	80.11	106.28	100.02
Reserve position in Fund	0.0	0.0	0.0
SDR Department			
Net accumulation	13.7	18.17	100.0
Holdings	15.2	20.16	110.99
Outstanding purchases and loans			
PRGF arrangement	3.99	5.29	4.99

Source: IMF, staff report, 2007

Table 2.2 below shows financial arrangements under PRGF since 1998.

Table 2.2 Rwanda: Latest Financial Arrangements

Type	Approval date	Expiration date	Amount approved (SDR million)	Amount approved (USD Million)	Amount drawn (SDR million)	Amount drawn (USD Million)
PRGF	June 12, 2006	June 11, 2009	8.01	10.6	2.28	3.0
PRGF	August 12, 2002	June 11, 2006	4.0	5.3	4.0	5.3
PRGF	June 24, 1998	April 30, 2002	71.4	94.7	61.88	82.1

Source: IMF, staff report, 2007

In order to reach completion point under HIPC initiative, Rwanda had to demonstrate, among other things, that it (i) has had a track record of compliance with macroeconomic and structural reforms under an IMF-supported program namely Poverty Reduction and Growth Facility for usually 3 years; (ii) has implemented key reforms agreed at decision point to the satisfaction of the IMF and the World Bank (IDA) and (iii) has successfully implemented a poverty Reduction Strategy Paper (PRSP) for a last year. The debt involved encompasses bilateral, multilateral and commercial debt but bilateral debt from the Paris Club creditors.

Table 2.3 Rwanda: Implementation of HIPC initiative

	Enhanced framework
Commitment of HIPC assistance decision point date	Dec-00
Assistance committed by all creditors(USD million)	695.5
of which: IMF assistance	
(USD million)	63.4
(SDR million)	46.79
Completion point date	Apr-05
Delivery of IMF assistance(SDR million)	
Amount disbursed	46.79
Interim assistance	14.45
Completion point	32.34
Additional disbursement of Interest income	3.77
Total disbursements (SDR million)	50.56

Source: IMF, Staff report, 2007

The Multilateral Debt Relief Initiative (MDRI) was introduced in 2005. The MDRI provides 100% debt relief to eligible member countries that are qualified for the assistance. The debt relief covers the full stock of debt owed to the fund as of end-2004 which remains outstanding as the time the member qualifies for such debt relief. The MDRI is financed by bilateral contributions and the Fund's own resources, as well as the resources already disbursed to the member under HIPC initiative. Table 2.4 show relief received from MDRI.

Table 2.4 Rwanda: Implementation of MDRI assistance¹²

Total Debt Relief (SDR million)	52.74		
Of which: MDRI	20.19		
HIPC	32.55		
Debt Relief by facility (SDR million)			
Delivery Date	GRA	PRGF	Total
January 2006	NA	52.74	52.74

Source: IMF, Staff report, 2007

¹² Under the MDRI, countries which have reached completion point under the HIPC Initiative will see their eligible stock debt stock owed to IDA, IMF, AfDF and IDB cancelled once they qualify.

2.2 The 2005 PRGF Arrangement

2.2.1 Terms of PRGF Arrangement

In Rwanda, PRGF conditions included quantitative performance criteria, as well as structural performance criteria and benchmarks: (i) the performance criterion on net credit to government to include treasury bill holdings of nonbanks to better monitor domestic borrowing by the central government; (ii) priority spending (including spending on the electricity sector); (iii) contingent spending: if budgetary support is available and the monetary program remains on track, there is an adjuster on net foreign assets, net credit to government, the domestic fiscal balance and priority spending.

Under the PRGF arrangement, structural conditionality continued to reflect areas of macroeconomic relevance:

- strengthening tax administration by increasing the number of audits of large taxpayers;
- improving public expenditure management;
- enhancing governance in connection with the payment of a government guarantee related to the 2003 hotel project;
- monitoring progress in implementing the export promotion strategy by a benchmark on the submission to cabinet of the first progress report of the Rwanda Investment and Export Promotion Agency (RIEPA);
- Undertaking further measures to strengthen and develop the financial sector after a comprehensive review.

2.2.2 Structural reforms (benchmarks) and quantitative conditions embedded in the PRGF arrangement

In 2005, the structural agenda focused on advancing the public sector reform and private sector development with a view to increasing productivity, particularly in exports. While sectoral policies have been spearheaded by the World Bank and other donors, IMF conditionality continued to focus on tax administration, public expenditure management, governance (in particular related to a large hotel project undertaken in 2003 by the government-owned entity Prime Holdings), export promotion and financial sector reform.

(1) Financial sector reform

Financial sector reforms continued building on findings of Financial Sector Assessment Program (FSAP) mission. The authorities noted that all banks (except one) had been in compliance with prudential regulations by end-2004. Further bank recapitalization would be undertaken after assurances that banks are sound and weaknesses are being addressed. The FSAP mission emphasized that supervisory authority would need to be given sufficient autonomy to strengthen its ability to enforce corrective measures.

(2) Export promotion

The authorities significantly strengthened their commitment to developing exports and tourism by adopting an approach that addresses issues in specific sectors as well as across sectors. In particular, budgetary allocations for the tea, coffee and tourism sectors increased to facilitate structural reform; strengthen the coordinating role of the RIEPA and take measures to diversify exports. At the same time, they intended to define specific actions to address problems that hamper all exports relating to infrastructure, customs administration, and access to financing. These actions have been discussed at the fifth review under the PRGF arrangement.

(3) Private Sector Development

To make the private sector the engine of growth, further progress was made in creating an enabling environment. A new land law, which, by improving the security of land tenure, could become a means to promote private sector credit without jeopardizing the quality of banks' lending.

Recent overhaul of the legal framework and progress in the privatization agenda were positive steps.

Quantitative Conditions

While preserving macroeconomic stability and strengthening exports through structural reform, the 2005 program under PRGF arrangement has laid the foundations for strong growth through increased spending in critical PRSP sectors. The program was based on a real growth rate of 4.0% and a reduction in inflation to 6.0% by end-2005, taking into account the impulse from the electricity tariff increase of about 2.0%. It was assumed that Central bank reserves could decline to over 4 months of imports.

(1) Fiscal Policy

Fiscal policies maintained macroeconomic stability¹³. The baseline program, which targets a domestic fiscal deficit of 4.5% of GDP, was tighter than in 2004 by almost one percent of GDP, reflecting lower nonpriority spending. However, the deficit would be allowed to widen further by up to about 2.0% of GDP from the release of contingent spending, if the additional spending is financed by external budgetary support and the monetary program is kept on track, which may require allowing a nominal appreciation of the exchange rate. The contingency enabled the authorities to review the impact of fiscal policy on domestic demand and closely coordinate with monetary and exchange rate policies.

Table 2.5 Fiscal program in 2005 (in percent of GDP)

	2004	2005	
		Including contingency	Excluding contingency
Revenue	13.9	14.0	14.0
Domestic expenditure	19.2	18.6	20.4
Priority spending(including electricity) ¹⁴	8.5	9.4	10.3
Other spending ²	10.7	9.2	10.1
Domestic fiscal deficit	-5.2	-4.5	-6.3
<i>Memorandum item:</i>			
Priority spending(excluding electricity)	7.5	8.8	9.7

Source: MoF and IMF, 2005

(2) Monetary Policy

The monetary program aimed at lowering inflation, while allowing an expansion in private sector. In 2004, the private sector credit had been constrained, among other things, by high nominal interest rates. High interest rates had been necessitated by rising inflation and ex-post real interest rates had declined. If government domestic spending threatens to push reserve money growth above the target in the program, foreign exchange sales would need to be stepped up to keep reserve money growth on track and protect the inflation objective to under the program. There was a close coordination between MoF and NBR. Given the program's money anchor, some nominal appreciation of exchange rate would need to be allowed. There should be pressures for real appreciation.

(3) External Sector

Reflecting continuing-project related import demand, the external current account deficit (excluding grants) would widen to 22.0% of GDP in 2005 and is expected to remain high over the medium term. This trend reflects a strong increase in imports of fuel and equipment related to the rehabilitation of the electricity sector and other priority projects while exports are expected to decline. One can conclude that, since many years, the adherence to quantitative conditionality was good in Rwanda but structural performance was less satisfactory.

¹³ Here, the program envisaged, in particular, cuts in nonpriority spending compared with the budget (including a rescheduling of loan repayments related to the 2003 hotel project, the purchase of an airplane for Rwanda air Express and the recapitalization of a housing bank through cash injection.

¹⁴ Electricity was not included in the definition of priority spending in 2004

¹⁵ Includes domestic interest bill, defense, and nonpriority spending

For example, in 2006, except for the limit on net credit to government all quantitative performance criteria were met. Also, in 2007, growth remains strong (6.0%) owing to buoyant activity in the construction and services sectors, despite a fall in agriculture production and inflation has abated due to the stabilization in food prices which declined to 8.0%.

On the structural front, progress was made. For example, efforts have been made in public financial management and reforms are beginning to show results. Also, to develop and strengthen the nonbank financial sector, the microfinance bill providing the legal and regulatory framework for microfinance institutions (MFIs) was submitted to Parliament in June 2007 and also an insurance bill to the Cabinet to supervise nonbank financial institutions. The targeted micro financial institutions and most banks have complied with the new capital requirements, which are geared at increasing the safety of the financial system (see IMF country Reports, 2007, February 2008).

Macroeconomic challenges

The program allow for a large fiscal expansion. It originally envisaged an increase from 2006 in the domestic deficit. With such expansion, close monitoring is needed to avoid crowding out the private sector and thus ensure the real resource transfer through an increase in nets imports. Due to increased aid from the fiscal expansion, inflation pickup beyond the program was possible but acceleration was to be prevented. The program envisages a growth rate of 4.5-6.5 %, inflation of 5.0% and international reserves of about 5 months. On the upside, there could be a supply response if all domestic spending is released. On the downside, agriculture production could be depressed and put upward pressure on inflation.

2.3 Outcomes of PRGF Reviews

Since many years, Rwanda is successfully implementing a three-year PRGF arrangement, in order to continue addressing challenges in achieving higher economic growth and reducing poverty. In line with program objectives set in a number of PRSPs, Rwanda's macroeconomic performance continues to be strong, with growth rate higher than expected, inflation declined, international reserves substantially exceeded program target in covering over 5.5 months of imports on average and fiscal realisations in line with the targets. As a result, the program and structural reforms remain broadly on track. Generally, all quantitative performance criteria set were met, except for the limit on net credit to government.

With regard to Rwanda's 2005 PRSP, the end-December 2004 performance criterion on priority spending was missed by one percent of GDP as the authorities needed to reallocate funds to address the acute electricity shortage¹⁶. Moreover, Rwanda did not meet the continuous performance criterion on the non-accumulation of external arrears in 2005.

Further, with policy implementation broadly on track, economic performance during 2005 remained in line with the program. Indications suggest that annual growth could be at the upper end of the 4-5% range, reflecting mostly an expected recovery in agricultural production due to good weather conditions. As a result of a poor first harvest and rising energy prices (including a doubling of electricity tariffs), headline inflation rose to 13.0% in March, but declined to 11.0% in June; inflation excluding these items remained subdued at around 5.0%¹⁷. A tighter-than-programmed fiscal policy helped to contain reserve money growth while international reserves increased to almost six months of imports at end-June 2005. As a result, all indicative end-March 2005 targets except the one on priority spending were met. Despite the tighter fiscal stance, the current account widened mostly due to unusually high NGO-related imports.

The fiscal stance in the first quarter of 2005 was tighter than programmed to preserve macroeconomic stability. Notwithstanding an over performance of non-tax revenue, the authorities temporarily restrained spending by about 0.7% of GDP compared with the program to ensure that reserve money target will be met.

¹⁶ While the Poverty Reduction and Strategy Paper (PRSP) identified electricity as a priority, it was not included in the definition of priority spending under the 2004 program. Otherwise, the target would have been met. For 2005, the definition of priority spending has been expanded accordingly.

¹⁷ With an expected fall in food prices later, the program's inflation objective of 6 percent at end-2005 remains achievable.

The expenditure restraint also affected priority spending, which fell short of the indicative target by 0.3% of GDP. Since then, the authorities have resumed their spending program, including on priority spending. A revised 2005 budget, in line with program understandings and including extended documentation as required under the missed October 2004 benchmark, was submitted to parliament at end-June 2005.

The current account deficit widened in the first quarter compared with the program, reflecting mainly a surge in externally financed imports. The exceptionally high imports stemmed mostly from NGO-related activities (medical supplies and infrastructure).

While they were financed from abroad, the tighter fiscal stance together with higher-than-programmed project disbursements resulted in a temporary increase in international reserves. During January-May, the nominal effective exchange rate appreciated by 6.0% and the real effective exchange rate by 11.0%. The authorities made good progress with their structural reform agenda and the two structural benchmarks for the first half of 2005 were met.

2.4 Indication of the Cost of the Reforms

Since 1999, IMF has supported the adjustment programs of its low-income members with loans on highly concessional terms through PRGF arrangement. This facility relies on two premises: (i) that macroeconomic stabilization and structural reform of economic system and institutions complement each other and (ii) that both are needed for economic growth with external viability.

The continued implementation of reforms has led to positive and significant macroeconomic developments in Rwanda. At the heart of structural adjustment undertaken lies the fiscal component of the program. Sound fiscal policy fosters macroeconomic stability. For one thing, sound fiscal policy work against inflation which is important given relatively limited financial intermediation in Rwanda and likely in most PRGF countries and the associated potential budget deficit to be monetized. Moreover, well-designed revenue and expenditure reforms may directly promote growth as well as enhance the economy's supply side response¹⁸.

More efficient revenue mobilization, for example, can fund needed public goods and services and help cut fiscal imbalances as well as promote investment and growth by reducing the adverse allocation effects of the tax system. On the expenditure side, more cost-effective public programs free resources for better uses and changes in the composition of public spending can reorient public resources away from current consumption and toward growth-promoting investment in physical infrastructure and in social and human capital.

¹⁸ See IMF(1998) in Fiscal Reforms in Low-Income Countries: Experience Under IMF-Supported Programs

3.0 THE PRGF and RWANDA'S DEVELOPMENT PROGRAMME

As already mentioned, PRGF-supported programs are framed around comprehensive, country-owned Poverty Reduction Strategy Papers (PRSPs). PRSPs are prepared by governments with the active participation of civil society and other development partners. PRSPs are then considered as the basis for the concessional lending instrument and debt relief under the joint HIPC-Initiative. The targets and policy conditions in a PRGF-supported program are meant to be drawn from the country's PRSP.

3.1 Main Tenets of Rwanda's Development Strategy

In Rwanda, the first cycle of the PRSP was completed in 2005. The second cycle of the PRSP, named the Economic Development and Poverty Reduction Strategy (EDPRS), process marks an important strategic and symbolic landmark in Rwanda's road to recovery from the devastation caused by the genocide. The review of development programmes of Rwanda are presented in the Economic

Box 1: Underlying Principles of the Rwanda EDPRS Process

1. Country-driven involving broad-based participation;
2. Results-oriented and focused on outcomes that benefit the poor;
3. Comprehensive in recognizing the multidimensional nature of poverty and in the proposed policy response;
4. Partnership-oriented involving coordinated participation of development partners;
5. Based on a long-term perspective for poverty reduction.

Development and Poverty Reduction Strategy (EDPRS). Those development programmes were set following extensive consultation with the sectors and those working on cross-cutting issues. Therefore, the EDPRS provides main tenets of Rwanda's development programmes. One of the major challenges of the EDPRS will be to outline new sources of broad based growth required for Rwanda to operate a successful transition towards long-term human and economic development.

The Millennium Declaration, which was adopted in 1997 by 197 Heads of State in 2000, emphasized the need to localize the MDGs by developing national development strategies that are based on the MDGs, and also that are adapted to suit national realities and priorities. The MDGs outline global consensus of what constitutes the minimum core of a sound development strategy. As such, the MDGs lay the normative ground for international development assistance and play an important role in structuring development around key issues, enabling a more streamlined and results oriented approach to human development.

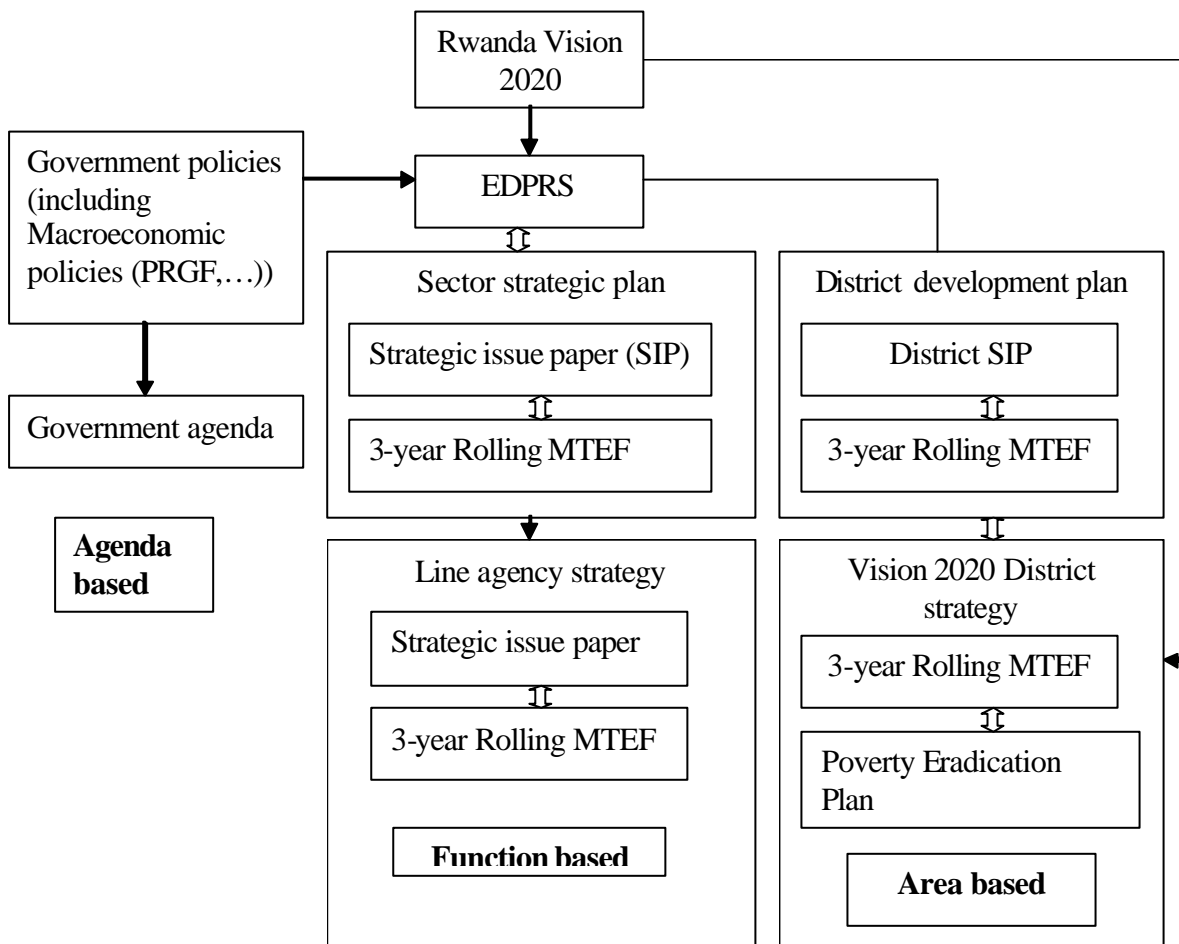
Rwanda Vision 2020 constitutes a perfect example of a localized MDGs based development strategy. There is no incompatibility between the MDGs and Vision 2020. Vision 2020 targets are virtually identical to MDGs targets in all sectors where an overlap is even though their interpretation sometimes differs. In deed, vision 2020 is broader than the MDGs in further more, vision 2020 is broader than the MDGs is terms of scope. Even though the MDGs will continue to be the basic of discussions with development partners, this should, in no way, detract the government from pursuing the development objectives set forth in vision 2020.

A review of the MDGs and Rwanda Vision 2020 targets provides a context for presenting the EDPRS targets for 2012. They were set following extensive consultation with the sectors and those working on cross-cutting issues. Two public expenditure scenarios are identified for the EDPRS and each scenario has a different set of sectoral targets. In the base scenario, real government revenue (including grants) is assumed to grow at 10-12% per annum from 2008 to 2012, while each sector's expenditure share remains constant at the level shown in the 2007 budget. In the high scenario, government revenue is assumed to grow at 20.0% per annum between 2008 and 2012, which was the average annual rate at which it grew between 2003 and 2007. Furthermore, in the high scenario the pattern of public spending changes in 2008 to benefit those sectors and subsectors most closely linked to the EDPRS priorities of accelerating skill-driven growth and increasing employment.

At the sector level, the main beneficiaries in the high scenario are agriculture (+ 15.7 percentage points in share of public spending), transport and ICT (+ 12.0 percentage points), energy (+ 7.7 percentage points), and housing (+ 4.1 percentage points). Among the sectors identified in the table, the losers include justice, order and public security (- 3.1 percentage points), health (- 3.0 percentage points) and education (- 2.1 percentage points).

In the high scenario, there is a significant reallocation of resources between different levels and types of schooling within the education sector. The major beneficiary is Technical and Vocational Education and Training (TVET), whose share of educational spending rises from 3% to 15.0%, which is equivalent to an increase in its share of total public spending from 0.6% to 2.3%. The expansion of TVET comes largely at the expense of basic education whose share of educational (total) spending falls from 42.0% to 30.0%. The expenditure share of secondary education rises from 21.0% to 25.0% of total education spending, while that of higher education declines from 22.0% to 20.0%.

Figure 3.1 Rwanda: Link between PRGF and PRSP
EDPRS in the planning system



Source: Rwanda EDPRS, 2007

3.2 The Linkages between the PRGF and Rwanda's PRSP

The PRGF and PRSP linkage is linked to the aid effectiveness principle of ownership. This means that PRGF-supported programs are framed around comprehensive, country-owned poverty reduction strategy paper. PRSP is then considered as the basis for concessional lending from IMF and World Bank and debt relief under the HIPC initiative.

HIPC thus, creates considerable pressure to speed up the transition to a full PRSP, while the relation between PRSP and PRGF would benefit from a slower pace in which improved consultation and quality could be achieved incrementally. The targets and policy conditions in a PRGF-supported program are drawn from the Rwanda's PRSP.

The poverty reduction strategy paper approach is now broadly accepted as the framework for bringing together national policies and donor support to help low-income countries make progress towards the MDGs. The IMF has adopted the PRSP approach for its financial support to these countries including Rwanda under the Poverty Reduction and Growth Facility. Close alignment of the PRGF and the PRSP remains a key principle for adapting the content and process associated with these programs. The IMF along with the World Bank and many other development agencies has committed to use the PRSP as the operational framework for its support to LICs under PRGF and to align the content and process of its operations to reflect this framework.

The focus here is on links between the PRGF and the PRSP in Rwanda, since a basic lesson of the early years of these instruments is that alignment of the PRGF and other donor supported programs with the PRSP will only become effective when the PRSP itself is closely aligned with the budget process in the country¹⁹.

The Sector Strategic Plans elaborate EDPRS objectives and strategies in more detail. Similarly, the District Development Plans draw from the EDPRS and the Sector Strategies in order to balance these national priorities with local needs identified at district level. The MTEF shows how funds in the coming three years will be used to generate the required outputs. The annual budget performs a similar function over a one year period. Arriving at a realistic MTEF and annual budget requires strong procurement planning.

EDPRS interacts with PRGF at the government level. This is very important because of credibility, close monitoring, and government. Also, this means that PRGF will fund development programmes set out in EDPRS which is a country-driven product.

3.3 Financing the EDPRS

The implementation of EDPRS will require RWF 5,151 billion over the five years to come (2008-2012). This amount includes public current expenditure, public capital expenditure and private investments. The public component amounts to RWF 3,436 billion and represents 67.0% of the total cost of EDPRS.

The table below shows the annual composition of these items.

Table 3.1 Rwanda: EDPRS costs, in billion RWF

	2008	2009	2010	2011	2012	Total
EDPRS costs (in billion RWF)	760	859	1,010	1,172	1,350	5,151
Public spending	550	613	677	757	839	3,436
Public recurrent expenditure	341	366	409	451	497	2,064
Public capital expenditure	209	245	270	306	342	1,372
Private investment	209	248	333	416	511	1,717

Source: MoF, 2007

The EDPRS financial requirements assessment calls for a big push in investments to reach USD 140 per capita (see the UNDP's Rwanda Human Development Report, 2007); the MDGs-based public investment needs calls for USD\$72 per capita. Although the EDPRS sets ambitious policies and programmes, the overall costs remain well below these assessments and, as result, some MDGs will not be achieved.

The allocation of public spending across sectors captures the EDPRS objective of balancing the social and productive sectors.

¹⁹ In the sense that policies supported by donor programs are derived directly from the PRSP. For the IMF, an important dimension of this is macroeconomic alignment, in the sense that the macroeconomic framework of the PRSP, of the associated Rwanda annual budget and of the PRGF-supported program is broadly congruent.

Table 3.2 Rwanda: Sector Allocation Costs

	Recurrent expenditure		Capital expenditure		Total	
	in billion RWF	Share (%)	in billion RWF	Share (%)	in billion RWF	Share (%)
Human development and social sectors	870	42.1	306	22.4	1176	34.2
Education 1/	553	26.8	128	9.3	681	19.8
Health and population 2/	188	9.1	127	9.3	315	9.2
Social protection	103	5.0	5	0.4	108	3.1
Employment and capacity-building	15	0.7	38	2.8	53	1.5
Youth, Sport and Culture	11	0.5	8	0.6	19	0.6
Capital development and Productive sectors	239	11.6	1012	73.7	1251.0	36.4
Infrastructure	107	5.2	571	41.6	678	19.7
Transport and ICT	12	0.6	235	17.1	247	7.2
Habitat	12	0.6	63	4.6	75	2.2
Energy	13	0.6	195	14.2	208	6.1
Meteorology	0	0.0	2	0.1	2	0.1
Water and Sanitation	70	9.4	76	5.5	146	4.2
Productive capacities	132	6.4	441	32.1	573	16.7
Agriculture	84	4.1	158	11.5	242	7.0
Forestry, Land and Environment	10	0.5	52	3.8	62	1.8
Manufacturing, Services and off-farm industry 3/	17	0.8	50	3.6	67	1.9
Science, Technology and Innovation	18	0.9	30	2.2	48	1.4
Community Development Fund (CDF)	3	0.1	151	11.0	154	4.5
Governance and Sovereignty	955	46.3	54	3.9	1009	29.4
Defense and Cooperation	288	14.0	3	0.2	291	8.5
Justice, Reconciliation, Law and Order	142	6.9	29	2.1	171	5.0
Public Administration	478	23.2	20	1.5	498	14.5
Decentralization	47	2.3	2	0.1	49	1.4
Total	2,064	100.0	1,372	100.0	3,436	
1/ Education MTEF						
2/ Exclude off-budget, private, indirect transfers						
3/ Mostly led by the Private sector						
Source: MoF, 2007						

The human development and social sector component absorbs 34% of the total expenditure (that is 42% of the total recurrent expenditure and 22% of the total capital expenditure). The capital development and productive sector component represents 36% of the total expenditure (respectively 12% of the total recurrent expenditure and 74% of total capital expenditure). Finally, both the social and productive sector components are supported by Governance and sovereignty expenditure (including public debt service) which represent 29% of total expenditure (that is 46% of recurrent expenditure and 4% of total capital expenditure).

There are, on the ground, four ways of financing a deficit: (i) borrowing from central bank, or "monetizing" the deficit; (ii) borrowing from the rest of the banking system; (iii) borrowing from the domestic banking sector and (iv) borrowing abroad, or running down foreign exchange reserves. Generally, each form of financing is associated with a major macroeconomic imbalance: excessive money creation with inflation, excessive foreign borrowing with an external debt problem; exchange rate crisis, and excessive domestic borrowing with high real interest rate and possibly with explosive growth in public debt from the dynamic interaction between interest payments, deficit and debt.

The analysis focuses on public and private expenditure required to achieve the EDPRS targets, taking into consideration the various constraints to which the Rwandan economy is exposed. It seeks to ensure the overall consistency between programmed expenditure and the available, committed and expected resources. Also, the analysis identifies the resources mobilization efforts required to support adequately the EDPRS while maintaining macroeconomic stability. Finally, the analysis describes the main sources of financing for Rwanda over the past years.

Public spending will be financed by a combination of domestic tax and non-tax revenues, external budgetary grants (i.e. budget support), external project grants and loans (i.e. project support) and external net borrowing. Domestic resources represent 50% of the total resources required for the EDPRS. Internal net borrowing will not finance the EDPRS but will serve a tool to smooth volatility in external resources and sterilise any adverse effects of capital inflows.

The following table provide the summary of the same information expressed in percentage of GDP.

Table 3.3 Rwanda: EDPRS Financing

	2008	2009	2010	2011	2012	Total
Public share of EDPRS costs in billion RWF	550	613	677	757	839	3,436
Financing in billion RWF	550	612	678	757	839	3,436
Domestic revenue(tax and nontax)	262	297	338	385	439	1,721
External committed budgetary grants	143	156	159	158	156	772
AfDB	11	14	13	13	13	64
Belgium	12	4	4	3	3	26
DfID-UK	36	32	32	32	32	164
EFA-FTI	25	30	32	32	32	151
EU	13	19	22	21	21	96
Germany	13	13	13	13	13	65
Sweden	6	6	6	6	6	30
World Bank	27	38	37	37	37	176
External projects grants and loans	0	0	0	0	0	0
Required additional Financing in billion RWF	145	159	181	214	244	943
Budget support	118	129	150	181	208	786
Project support	27	29	30	33	36	155
<i>Required financing in % GDP</i>	<i>6.7</i>	<i>6.5</i>	<i>6.6</i>	<i>6.9</i>	<i>7</i>	
Required additional financing in million USD	266	294	338	403	464	1,765
Budget support	216	240	281	341	396	1,474
Project support	50	54	57	62	68	291

Source: MoF, 2007

Firstly, in so far as budget support is concerned there is a need for RWF 968 billion for the EDPRS period. External committed budgetary grants are estimated at RWF 772 billion. Most development partners provide data on commitments for two to three years ahead only. These commitments fall short of the needs, leading to a financing requirement of RWF 196 billion (equivalent to USD 369 million). Secondly, in so far as project support is concerned there is a need of RWF 746 billion for the EDPRS period 2008-2012. Considering the resource envelop from project donors and the current and the current portfolio of projects, RWF 590 billion can realistically be mobilized. This translates into financing deficit of RWF 156 billion (equivalent to USD 291 million). Together the total financing requirement is RWF 352 billion (USD 661 million) for the EDPRS period, or an average of USD 132 million per year, over and above the assumed commitments.

3.4 Programmes to Which PRGF Funds Directed

Donor agencies have been key players in Rwanda since 1994. With the support from the international community under the PRGF, Rwanda has made notable progress along an ambitious path of reconstruction and economic reforms. In recent years, the government of Rwanda has made some ambitious efforts, based on poverty reduction strategy paper to reduce poverty and improve living conditions of the poor population.

In support of Rwanda development programmes as highlighted in the PRSP, the PRGF funds have been disbursed. The composition of spending has been further oriented toward PRSP priorities, envisaging an increase in priority spending while non priority spending is expected to fall. For example in 2007, priority spending focused both on the social sectors and productivity-enhancing strategies. For instance, central government priority spending is defined as the sum of those recurrent expenditures and domestically financed capital expenditures that the government has identified as priority in line with the PRSP or EDPRS process. Priority expenditures are based on the program classification of the annual budget. In this context, PRGF funds have been directed to the following programmes:

Table 3.4 Rwanda: Priority activities identified in the PRSP

1	Intensifying small-scale agriculture and live stock including extension, credit, and support to marketing
2	Labour-intensive works including environmental infrastructure and rural roads.
3	Malaria and HIV/AIDS prevention and support to health(health insurance)
4	Primary school text books.
5	Economic infrastructure (including rural road maintenance, rehabilitation and rural electrification.)
6	Skills development (for youth, women, and small business start-up schemes.)
7	Adult literacy
8	Gacaca jurisdictions
9	Demobilization and reintegration (into socio-economic activities.)
10	Shelter provision for the homeless.
11	Development of sector strategies.

Source: MOF, EDPRS, and IMF Staff Report, 2007

Spending in education and health has been increased (0.6% of GDP) reflecting the elimination of school fees for the first three years of secondary education and program in health sector. Allocations for the decentralisation process have been increased to improve public service delivery. As poverty remain wades priority spending has been monitored more directly, targeted to alleviate poverty and defined in close coordination with donors. With respect to productivity enhancing strategies, the allocation has been maintained for agriculture, infrastructure and energy.

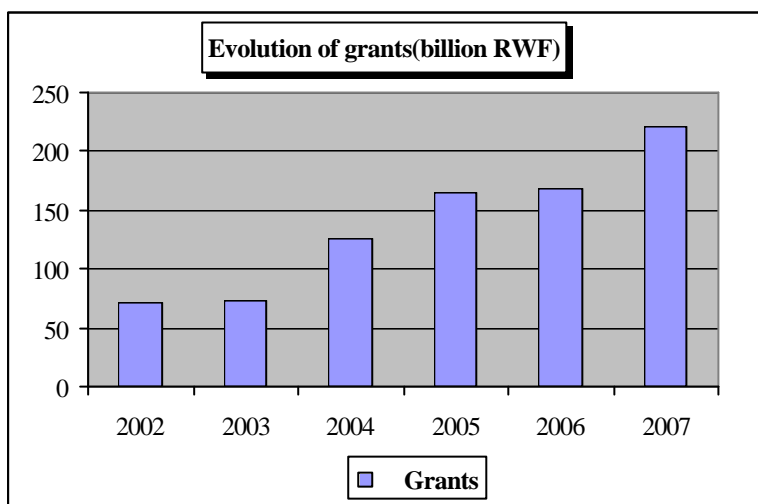
New spending priorities have been identified:

- Fast track Education initiative;
- Priority communication;
- Lake Kivu pilot project;
- Food imports;
- Emergency spending for flood victims;
- Emergency rehabilitation of electricity transmission;
- Sterilization cost to NBR.

3.5 Impact of IMF's Signalling Role on Aid Disbursements

The IMF has played a critical role in Rwanda. Public actions and commitment to reduce poverty requires resources in particular for social services and the MDGs. Rwanda needs much resources and coherence of country's plans to use the resources is a significant achievement. To allow macroeconomic concerns to be an obstacle to the disbursement of these resources is either to argue that there are very acute macroeconomic risks or to underestimate the magnitude of Rwanda's needs. Indeed, the consequences of excessive macroeconomic restraint can be not good for the poor.

Figure 3.2 Evolution of grants (billion RWF)



Based on the figure above, the aid in Rwanda has been volatile over time, but in upward trend. This is attributable to the fact that aid disbursement on Rwanda is primary based on the PRGF program performance. The process of negotiation might benefit from the participation of a wider range of stakeholders. The IMF's disapproval of macroeconomic programmes is effectively treated by some donors as a strong signal that something is not going well in the country economy. This means that the judgements reached by IMF teams have a wider significance. Given their importance, these judgements need to be informed by the views of economists in other institutions such as the World Bank. In particular, many of the issues discussed involved micro-macro linkages that are acknowledged by IMF staff to be out of their competence. The separation of micro from macro judgements undermines the quality of overall macroeconomic assessment.

Moreover, the IMF tends to represent one end of a spectrum of technically competent views on macroeconomic stance, and the views of country teams that are sometimes more inflexible than the views of other parts of the IMF. While this would not be a problem if the IMF were simply one among many donors (there is no reason why some donors should not be more conservative than others. It becomes a problem when IMF's verdict taken as an authoritative signal for the actions of the whole donor community. Whether the IMF could go so far as to participate in joint donor review of the whole PRSP is not clear, but macroeconomic discussions need to be more closely integrated into the other policy discussions. Also, the Rwanda's own capacity to engage in the debate needs to be reinforced by improved macroeconomic modelling capacity. With this respect to the IMF signalling role, aid has been disbursed to Rwanda.

4.0 THE PRGF and FISCAL SPACE

Fiscal space refers to the ability of government to make budgetary resources available for desired purposes. Fiscal space has been defined by both the IMF and the United Nations Development Programme (UNDP). The IMF's approach to fiscal space is the room in a government's budget that allows it to provide resources for a desired purpose without any prejudice to the sustainability of its position or the sustainability of economy (IMF, 2007)²⁰. In the IMF's approach, it is short-term fiscal solvency and macroeconomic stability considerations that determine the possibility of mobilizing additional resources for development. Government can create fiscal space through the following types of fiscal instruments: external grants, domestic revenue mobilization, deficit financing, and reprioritization and improving the efficiency of expenditures. The UNDP approach to fiscal space is that it is the financing that is available to government as a result of concrete policy actions for enhancing resource mobilization and the reforms necessary to secure the enabling governance, institutional and economic environment for these policy actions to be effective or a specified set of development objectives (Roy et al, 2007).

The achievement of MDGs and any development programme or economic transformation requires significant scaling up of resources for public investment. This means that UNDP's approach calls for a need to consider the long term impact on fiscal sustainability and macro stability and to relax fiscal requirements in the short term. The long term benefits of securing human development outcomes are the primary considerations, which need to be weighed against fiscal sustainability considerations.

Fiscal space also has an inter-temporal component. Essentially, the effective use of resources today leads to increased productivity in the economy generates a larger base of resource (human and physical capital and incomes) for tomorrow's economic choices (wealth can be saved and invested, or consumed). When significant investments are required, as in Rwanda today, decisions are needed as to whether to reduce current or future consumption to pay for them. In case of Rwanda, public consumption today can be increased (at the cost of future public and private consumption) through borrowing.

It is important to note that fiscal space is country specific. The policy choices for finding fiscal space depend on the country's fiscal framework, including its characteristics, constraints, and policy agenda. Thus, while some countries may need to raise more revenues to finance their expenditure envelope, others may want to reduce the tax burden. While some countries may be able to acquire more debt cheaply, others may be above their debt limits or may be able to raise funds only at high overall costs to the economy. While some countries may want to reallocate expenditure from one area to another while maintaining the same level of expenditure, others may want merely to phase out or cut programs thus, reducing the overall size of the government.

In the case of Rwanda, the economy quickly comes up against two tensions: debt sustainability and macroeconomic pressures. Thus, policies geared to create fiscal space should also ensure solvency for future generations by allowing more productive and growth-enhancing public spending and by reducing distortions that hamper growth.

The countries benefiting from debt cancellation can enjoy more policy space in many ways.

- (i) Debt relief frees up fiscal space previously occupied by debt service, as more resources are now available to the government budget.
- (ii) The expanded policy space which accompanies debt relief service can facilitate greater government autonomy on how those resources can be utilized for example in choosing the priorities for the government.

²⁰See also Heller (2005) who stipulates that, broadly, fiscal space can be defined as the availability of budgetary room that allows a government to provide resources for a desired purpose without any prejudice to the sustainability of a government's financial position. In principle, there are different ways in which government can create fiscal space. Additional revenues can be raised through tax measures or by strengthening tax administration. Lower priority expenditures can be cut in order to make room for more desirable ones. Resources can be borrowed either from domestic or external sources. Governments can use their power of seignorage (that is having the central bank print money in order to lend it the government). Governments may also benefit from any fiscal space arising from the receipt of grants from external sources.

- (iii) The government now has more freedom to choose from various options in its macroeconomic policy, social policies and medium and longer term development policies and strategies (including plans for the agriculture, industry and services sectors).
- (iv) Government has more freedom to choose from a wider range of financing options for project and national plans from a variety of different sources.

A significant constraint on national policy space in low-income countries in the past two decades has been uncompromising debt burden for these LICs and the policy prescriptions which accompany country attempts to reschedule debt owed to external creditors and to mobilize additional external financial resources to meet their resource gaps.

4.1 Impact of the PRGF on the National Budget and Medium-Term Expenditure Frameworks

In Rwanda, the Medium Term Expenditure Framework (MTEF) approach to budgeting has been in place since 2001. The MTEF aims at making budgeting more strategic and linking budgets to outputs and is now a well-established practice in different Ministries, Provinces and central agencies. Rwanda's MTEF system was further strengthened in 2003 through the design of a common programme nomenclature for the recurrent and development budgets, while districts prepared MTEFs for the first time. Success in linking strategic plans with the budget will mainly come through the development of sector strategies results. The Education sector is the best example to date in Rwanda, while in 2004 the health sector piloted a system of results-based budgeting. Work is continuing on harmonizing the budget and project support.

The MTEF and annual budget serve as the basis from which ministries, districts, and other spending agencies derive annual work plans; first for each unit, and subsequently for each individual staff member working in that unit. For planning to be effective, regular reporting must occur to gauge whether efforts are yielding the desired results. The different planning tools aim to achieve *ex ante* compatibility of incentives between different levels of the administrative hierarchy. This is so that civil servants are motivated to achieve objectives, which are consistent with high level planning priorities. These planning tools are matched to a reporting path which exacts *ex post* accountability in the reverse direction.

For example, using the METF as a basis for wider consultation on the government's EDPRS could be an effective means of both strengthening the MTEF process and engaging civil society in the identification of priorities. This could promote a stronger basis for monitoring and evaluation and accountability.

Fiscal policy (an element of PRGF) needs to be based on well-prepared MTEFs and the annual budget should be aligned with the Government's medium-term planning goals, such as the EDPRS. The MTEF process in Rwanda appears to have been weakened by government staff turnover and retrenchment. Ambitious sectoral strategies as expressed in Rwanda PRSP could put the overall fiscal balance at risk, if they are not based on a well-defined MTEF process.

MTEF has been playing a central role both in planning and management of public expenditure and as importantly provides an anchor for the budgetary process. As the system matures so an increasing number of donors including IMF and the World Bank have started to coordinate their activities around the Rwandan government's own planning cycle.

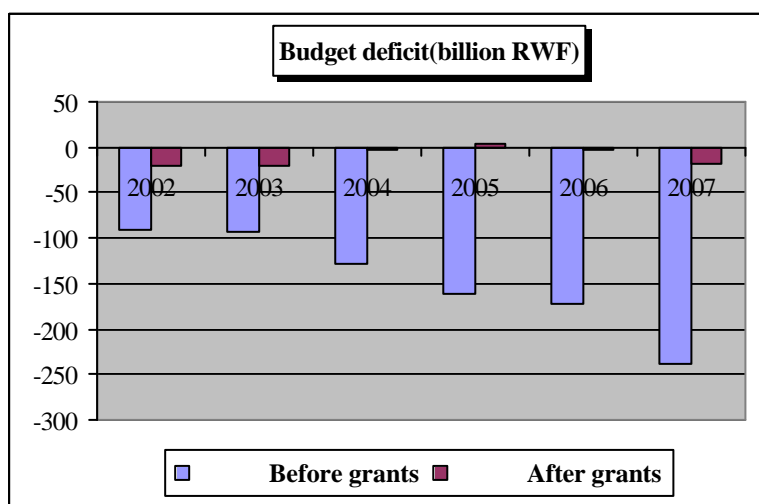
The main source of the budget deficit in Rwanda, appear to be the current expenditure, 65% of total expenditure. This rate is high as compared to other African countries. The driver has been significant in the minimum wage (which affects significantly the public wage bill) and at the same time, capital spending has actually been rising.

Table 4.1 Rwanda Public Finance

	2002	2003	2004	2005	2006	2007
Total revenue	171.9	195.5	272.5	344.7	375.9	472.3
Tax and non tax revenue	101.1	122.4	147.0	180.2	207.2	252.0
Tax revenue	94.5	114.7	134.6	162.5	192.6	237.8
Non tax revenue	6.6	7.7	12.4	17.7	14.6	14.2
Grants	70.8	73.1	125.5	164.5	168.7	220.3
Grants (% of total revenue)	41.2%	37.4%	46.1%	47.7%	44.9%	46.6%
Grants (% of GDP)	9.1%	7.7%	11.0%	12.4%	10.3%	12.1%
Revenue (% of GDP)	22.0%	20.5%	23.9%	25.9%	23.0%	25.9%
Total expenditure	191.6	216.2	274.9	340.9	379.0	491.3
current expenditure	134.6	161.1	163.8	214.9	250.7	313.0
capital expenditure	56.4	51.1	89.5	121.4	118.7	186.3
of which foreign financed projects	50.9	37.9	62.3	86.7	83.0	100.3
Net lending	0.6	4.0	21.6	4.6	9.6	-8.1
Total expenditure (% of GDP)	24.5%	22.6%	24.2%	25.6%	23.2%	26.9%
Current expenditure(% of total expenditure)	70.3%	74.5%	59.6%	63.0%	66.1%	63.7%
Current expenditure (% of GDP)	17.2%	16.9%	14.4%	16.1%	15.4%	17.1%
Capital expenditure (% of total expenditure)	29.4%	23.6%	32.6%	35.6%	31.3%	37.9%
Capital expenditure (% of GDP)	7.2%	5.3%	7.9%	9.1%	7.3%	10.2%
Budget Deficit (payment order)	-33.5	-38.7	-16.8	-34.7	-43.5	-61.0
Overall deficit						
Before grants	-90.5	-93.8	-127.9	-160.7	-171.8	-239.3
% of GDP	-	-9.8%	-	-	-	-
	11.6%		11.2%	12.1%	10.5%	13.1%
After grants	-19.7	-20.7	-2.4	3.8	-3.1	-19.0
% of GDP	-2.5%	-2.2%	-0.2%	0.3%	-0.2%	-1.0%
Financing						
External Financing	30.5	20.9	48.1	34.3	34.9	32.1
Domestic financing(banking and nonbanking)	0.4	5.2	-24.2	-32.5	-16.9	-4.9

Source: NBR, Annual Reports and Author calculations

Chart 4.1 Rwanda Budget Deficit, billions RWF



Source: NBR

To measure the impact of PRGF on the national budget, one could mention that Rwanda budget is donor funded. Since 2002, grants have accounted for 44.0% of total revenue on average. Under the PRGF arrangement, achieving Rwanda's development objectives as highlighted in the PRSP, required and will require strong mobilization of resources, beyond those currently identified.

The planned expenditure path is driven by the government's conservative assessment of forthcoming aid flows and would require hard-to-achieve spending prioritization, considering likely spillovers from the investment program, pressures on the wage bill, and increasing transfers to the provinces and districts. This underscores Rwanda's dependence on additional foreign grants. Furthermore, the EDPRS does not project an increase in the revenue-to-GDP ratio; aiming for more ambitious revenue targets would be an important factor in reducing Rwanda's dependence on aid over the long term.

The long-term debt sustainability warrants close monitoring. To complement current and projected donor commitments, the Government estimates an additional financing requirement of RWF 352 billion (about USD660 million) over five years or about USD130 million a year. Additional borrowing of this size would rapidly worsen the medium-term outlook for debt indicators. Thus, the debt sustainability analysis indicates that Rwanda remains at a high risk of debt distress. Therefore, the financing plan will require a significant scaling up of grant financing in order to ensure debt sustainability. Government efforts to develop a debt management strategy (embedded in a medium-term macro framework) are needed and the related institutions and processes. The Rwandese authorities are encouraged to accelerate implementation of their export promotion strategy to strengthen and diversify the export base.

External financing should take into account the fragile debt position of Rwanda in the HIPC/MDRI initiatives. The IMF suggests that external financing should take the form of grants or highly concessional loans. GDP growth may also create some fiscal sustainability consistent space²¹.

Table 4.2 shows recent trends in wage bill, social and exceptional as proportions of GDP. It can be concluded that the wage bill has not increased as proportion of GDP since many years and that defence (security) has been falling since 1999. Social and exceptional expenditure have in the meantime significantly increased. These trends amount to a significant reallocation that is evidence of the seriousness of the Rwanda government's anti-poverty strategy.

Table 4.2 Rwanda: Sectoral Allocations of Recurrent Public Expenditure, as % of GDP

	2002	2003	2004	2005	2006	2007
Current expenditure	17.2	16.9	14.4	16.1	15.4	17.1
Of which wage bill	5.1	4.5	4.6	4.3	4.7	4.8
Goods & services	4.0	4.3	4.5	5.4	5.4	5.4
o/w: Defence (security)	3.6	2.4	2.3	2.1	2.1	2.1
Social (priority)	36.1	7.5	8.5	10.0	11.1	11.3
Exceptional expenditure	2.7	2.1	1.7	3.0	2.5	0.9

Source: NBR and MOF Reports

4.2 Impacts of PRGF Structural Benchmarks and Quantitative Conditions on Fiscal Space

The fiscal space in Rwanda and spending of aid flows can be seen as a case of the transfer problem in economics: How can financial flows (financial assistance under PRGF) be translated into real flows of goods and services? More explicitly, what is the impact of the PRGF on fiscal space in the context of Rwanda's development programmes? A challenge for Rwanda, as in many other African countries, has been to ensure that it can absorb and spend higher aid effectively without jeopardizing macroeconomic stability.

²¹ See Rathin Roy in the study "Fiscal space for achieving the MDGs: Analytical challenges and policy actions", 2007

In the balance of payments, financial flows may occur through many channels: an exogenous sustained portfolio capital inflow, inward bound private direct investment flows, or through aid transfers, for example. Aid inflows in the form debt as well as grants give rise to the transfer issue.

The solution can be found through direct import of goods and services: for example inward bound investment may be directly associated with import of capital goods. If the import content of new spending is low however, then adjustment will occur through macroeconomic channels. This will take the form of real effective exchange rate appreciation (REER), leading to increased net imports. The REER can take the form of a nominal exchange rate appreciation as the foreign exchange is sold in the market or a decline in trade competitiveness through a rise in domestic inflation. The latter will occur over time if foreign exchange is not sold, foreign reserves are built up and the base money expands. An expansion of the money base can be prevented by domestic sterilization (that is mopping up money base liquidity by government spending by selling treasury bills for example). This can have the effect of crowding out private expenditure. Nkusu (2004) notes that if excess capacity exists, aid-induced spending can stimulate growth.

As Hannah and Rutayisire (2007) point out, absorption of aid means the use of the financial inflows of foreign exchange to purchase additional net imports. Spending aid inflows means the use of the local currency equivalent to finance additional government spending in the context of development programmes. Allen (2005) presents and uses this framework for several African countries to perform an evaluation of the extent to which they have absorbed and spent aid. Rwanda's recent performance in the absorption and spending of aid inflows is calculated and compared to African countries. The table below shows a calculation for Rwanda's aid absorption and spending following Allen's methodology. For this, three periods are chosen, corresponding to those relatively low, moderate, and high aid periods.

Table 4.3 Rwanda: Absorption and Spending of Aid

	(1) Low aid period: 1998-99 (average)	(2) Moderate aid period: 2000-03 (average)	(3) High aid period: 2004-2006 (average)	Change: (2)-(1)	Change (3)-(2)
Aid (% of GDP)	5.6	8.6	13.3	+3.0	+4.7
Current account (before aid transfers in % of GDP)	-17.0	-17.5	-0.5	-3.0	-3.0
Fiscal deficit before aid transfers, in % of GDP)	-9.2	-9.9	-12.9	-0.7	-3.0
% of increased aid absorbed				17.0%	64.0%
% of increased aid spent				24.0%	63.0%

Source: See Hannah (2007) and Rutayisire (2007) in "Absorption and spending of Aid inflows: Perspectives on Rwanda's experience" and "Increase aid inflows and Macroeconomic challenges" and Authors' calculations

By these measures, Rwanda did not absorb or spend much the incremental aid in the first period, ended 2003. However, in the more recent period ended 2006, the proportion for both rose to 63.0% and 64.0%. It is also worth noting that in each period, the levels of absorption and spending are similar (if the aid was absorbed, a similar proportion was spent). This is not always the case, as demonstrated: the table below compares these results for Rwanda to 5 African countries over the period ended 2003 as calculated by Allen (2005).

In the Allen's study (2005), the main point is that countries typically do not absorb and spend all the aid they receive, as seen above. Particularly, there is a reluctance to absorb aid through the appreciation of the REER, due at least in part to concerns about competitiveness.

Results for Rwanda are within the ranges experienced by the other African countries, which vary within a wide margin. In particular, Rwanda did not experience the less desirable combination of spending but not absorbing aid as did Mozambique, Tanzania, and Uganda.

Table 4.4 Absorption and spending of aid: African comparisons

Country	Period	% of Aid absorbed	% of Aid spent
Rwanda	2000-03 vs. 1998-99	17	24
	2004-06 vs. 2000-03	64	63
Ethiopia	* ₁	20	7
Ghana	*	0	0
Mozambique	*	66	100
Tanzania	*	0	91
Uganda	*	27	74

Source: See Allen (2005) and from Author's calculations

It is also worth noting that from these tables above, fiscal space has been constrained by structural and quantitative conditions prescribed in the PRGF. Accommodating a substantial fiscal expansion from scaling of aid will require prudent management of macro policies. For example in 2006, a rapid increase of broad money (currency and deposits at commercial banks) was observed. Broad money was 31% higher by December 2006 compared with December 2005. The expansion was mostly driven by an increase in private sector credit, while the increase in the last quarter could be the result of temporary build up of deposits of local governments or government suppliers.

This expansion also affected the reserve money that is commercial banks' deposits at the central Bank. Therefore, reserve money exceeded the last day of each quarter as the program was quarterly based. There was a risk that an upward trend could lead to relaxed monetary policy and create a room for continued fast money growth.

In terms of foreign exchange, the central bank sold it to the commercial banks in 2006 but at the same time, net foreign assets of the central bank grew between December 2005 and December 2006. Here, the IMF's preferred policy is that the central bank should sell more exchange and allow the exchange to appreciate. This would make imports cheaper and thereby raise imports of goods and services. This is likely to be a relatively pro-poor policy, as many important items (imported fuel and consumer goods) would become less expensive for people in Rwanda.

On the fiscal front, expansion was expected to result in pressures for a real exchange rate appreciation. To ensure that these pressures do not jeopardize macrostability there has been put in place a safeguard. (i) Prudent management of scaled-up aid focused on preventing a crowding out of the private sector, building up costly domestic debt or rekindling inflation. In this respect, domestic debt was monitored as an indicative target. If the target is exceeded, this is a signal that spending increase is too rapid, forcing the central bank to resort to sterilize the liquidity from additional spending through domestic paper. (ii) Maintain the revenue to GDP ratio of 14.7% of GDP. An increase in the petroleum excise is expected. (iii) Almost all new spending was for priorities. About half is for new school buildings and laboratories, the purchase of education materials and wages for teachers under umbrella of Fast Track Education Initiative (FTEI). Other priority items included food imports, additional Funds to complete the Lake Kivu Gas pilot project and emergency assistance to flood victims in Western Province for property and infrastructure repairs. Non-priority spending increased due to especially the resettlement of refugees from Tanzania.

4.3 Fiscal Space: Has it Increased or Decreased?

Government revenues (tax and non-tax revenues), as opposed to borrowed resources, have the advantageous feature that they impose no further debt burden (either domestic or external). This means that these resources are to be preferred if there is a wish to keep public finances stable in the short term. However, revenue mobilisation incurs economic and social costs. As part of the quest to mobilize resources optimally, is it possible to increase revenue levels without causing unacceptable social problems (e.g. increasing poverty) and without increasing the economic distortions which discourage activity and undermine growth? This is a critical question for the development of fiscal space. Another key question is how much additional fiscal space can be created for increased aid, domestic revenues and growth.

Table 4.5 Rwanda: Fiscal program 2006-2007 (Percent of GDP)

	2006 Program	2006 Actual	2007 Program	2007 Actual
Revenue	15.0	15.1	15.0	14.7
Expenditure	21.9	21.3	22.9	23.8
<i>Priority</i>	10.9	11.0	12.5	13.6
of which: Emergency food imports				0.3
<i>Non priority</i>	8.9	8.7	8.8	8.7
Interest	0.8	0.6	0.6	0.5
Peace keeping support	0.8	0.8	0.7	0.7
Demobilization	0.5	0.2	0.3	0.3
Domestic Fiscal deficit (excluding AU peacekeeping and demobilization)	-5.6	-5.1	-6.8	-8.1

Source: IMF staff reports, 2006 and 2007

When analyzing the fiscal programme sectoral allocations of recurrent expenditure, it is important to highlight that Rwanda, under PRGF, has been able to make budgetary resources available for desired purposes. For example, social priority spending has been increasing substantially while security decreased. Rwanda increased goods and services and maintained constant wage bill.

Further with regard to fiscal program for 2006 and 2007, it is worth noting that it allows increasing priority spending as expressed in the development programmes (EDPRS). Also, the fiscal program allows the possibility to increase domestic fiscal deficit, which has indeed occurred. As noted above fiscal reforms are necessary for ensuring macroeconomic stability and enhancing the efficiency of, among other things, of public expenditures. The PRGF process has then been accompanied by marked increase in flexibility.

5.0 CONCLUSIONS

Rwanda's macroeconomic performance in recent years has been solid, with real growth of 5.8% per annum on average between 2000 and 2007. This performance has been supported by three factors: (i) the level of utilization with excess capacity provided under PRGF, which acts as a productivity reserve despite significant obstacles to private sector investment and rising real wage costs; (ii) the positive external environment, with tea and coffee prices that were well above their historical averages; (iii) the gradual progress made in structural reform, in particular the stabilization efforts in these recent years combined with increasing transparency in the corporate sector, and a development programmes through PRSP or EDPRS as its key policy direction.

Rwanda macropolicies continued to focus on poverty reduction initiatives, lay the base for stronger medium-term growth and continued to safeguard macroeconomic stability. On inflation level, it was intended to maintain inflation within single digits, and a level of international reserves of about 4.5 months of imports. Macroeconomic and structural policies also focused and will continue to emphasize on improving public financial management, developing the financial sector, and growth-enhancing investments and reforms under PRGF.

To monitor the implementation of the poverty reduction strategy, there will be the need of cooperation with donors (World Bank and IMF). In addition, there will be two types of indicators: (a) indirect process or action indicators, monitoring the progress of reform implementation, and (b) output or performance indicators that are directly linked to the final output. Donors are expected to begin using a subset of these indicators as triggers for their disbursements in the future.

Some key considerations going forward include the following:

- multi-year ceilings for total spending, line ministry spending (including capital and recurrent spending), and multi-year sector strategies/planning for all line ministries should be introduced;
- a database of current assets and their condition should be established for each line ministry;
- the MoF should more closely monitor capital project implementation during the year with line ministries, to assure that progress is being made and to identify and resolve any bottlenecks;
- the MoF should form a working group to review all aspects of capital budgeting from identification through completion and prepare a report on changes and improvements to the process;
- the MoF should review current budget execution procedures for capital projects to review their adequacy and ensure that they are not contributing to the under-execution of capital spending;
- annual audits of internal control and internal audit processes in line ministries of capital project management should be conducted until performance improves;
- and donor assistance should be progressively integrated into government PFM systems requiring these systems to be upgraded to conform to internationally accepted fiduciary standards while at the same time forcing donors to coordinate their assistance more effectively among each other and streamline their support with government priorities.

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Annex Material

Annex 1: Rwanda: Structural conditionality, 2006-2007

Public expenditure management			Status
Issue draft accounting instructions, forms, and procedures for budget users.	December 31, 2006	Benchmark	Net met Implemented in May 2007
Complete progress report on financial reporting by budgetary agencies (line ministries, provinces, autonomous agencies). Agencies are expected to produce the following monthly financial reports: (i) bank reconciliation statement; (ii) budget execution reports, and (iii) statements of revenue and expenditure.	June 15, 2007	Benchmark	
Publish on the Ministry of Finance's website the progress report on the OBL implementation.	September 30, 2007	Benchmark	
Complete and publish on the Ministry of finance's website a study on project accounts (for projects listed in paragraph 46 of the TMU) at the NBR (1) showing annual budgets with donor disbursements and spending for 2004 -2006 as well as quarterly projections (including a breakdown into imports and the domestic component) for July 2007-June 2008, and (2) providing an analysis of the causes for the large accumulation of the specific project accounts since January 1, 2004.			
Civil service reform Undertake a comprehensive review of the wages included in transfers to local governments.	December 31, 2006	Benchmark	Not met Converted to September 30, 2007 benchmark
Private sector development Make operational the office of the Registrar of Land titles	October 31, 2007	Benchmark	
Poverty reduction Produce a poverty profile of provinces, districts and communities of Rwanda using the results of census and the household living conditions survey.	September 30, 2007	Benchmark	
Financial sector: submit to Parliament micro finance law to bring the legal framework for microfinance broadly in line with the Guiding Principles on Regulation and Supervision of microfinance institutions as published by the Consultative Group to Assist the Poorest.	June 30, 2007	Benchmark	
Agricultural sector Adopt and publish a national fertilizer distribution strategy.	February 28, 2007	Benchmark	Not met Implemented in April 2007
Public expenditure management Undertake a comprehensive review of the wage structure of the public sector, including fringe benefits and wages included in transfers to local governments.	September 30, 2007	Benchmark	
Publish on the Ministry of Finance's website the first consolidated execution report of local governments showing transfers and budget execution per major line items per district and per province for the period January-April.	July 31, 2007	Benchmark	

Annex 2 Rwanda: Development Programme

Priority area	Indicator	Baseline (2006-2007)	Target 2012 High Scenario
Growth and poverty reduction	Real GDP growth (% annual)	6	8
	Export growth (% annual)	8	15
	National investment (% of GDP)	17	27
	Share of population living in poverty (%)	57	46
	Share of population living in extreme poverty (%)	37	24
Widen and deepen the financial sector	Private sector credit (% of GDP)	10	18
	Financial depth (broad money/GDP)	17	35
Develop skills	Pupil/teacher ratio in primary schools	70	54
	Pupils/classroom in primary schools	70	54
	Net secondary school enrolment	10	40
	Number of TVET graduates	8,250	9,200
Raise agricultural productivity and ensure food security	% of agricultural land protected against soil erosion	40	64
	No of hectares irrigated	130	1,051
	Use of mineral fertilizer (kgs/ha)	8	12
Improve environmental management	Measure of biodiversity		
Build infrastructure	Electricity generation (off/on grid, MWh)	41	114
	Road network in good condition	41	80
	ICT (composite network coverage)	4	20
Enhance capacity and increase employment	Number of additional full-time non-farm jobs created (per annum)		
	Employment in agriculture (% reporting as main occupation)	80	
Improve health status and reduce population growth	Infant mortality (deaths per 1,000 live births)	8.6	7
	Maternal mortality (deaths per 100,000 live births)	750	600
	% of population covered by health insurance schemes		100
	% of women aged 15-45 using modern contraceptive techniques		
	% of children fully immunized	75	100
Increase access to safe drinking water and sanitation	Access to safe drinking water (% of population)	36	
Integrate and extend social protection			
Strengthen governance, security and the rule of law	No of genocide prisoners on remand		
	Public financial management		

Source: Rwanda, EDPRS 2007

Annex 3: Interview Questions

- Why is a fiscal framework needed for the long term?
- Can long term fiscal policy positively impact human development? But may be not growth?
- What are the fiscal indicators for a long-term fiscal framework?
- What are long- term instrument for resource mobilization?
- Are efficiency gains and expenditure switching necessary but insufficient tools for enhancing fiscal space?
- Two issues that undermined scaling up of aid?
- What are other instruments required to enhance fiscal space for the MDGs in Rwanda?
- Fiscal space for development in Rwanda: key issues?
- Why is fiscal space important for financing development programmes?
- Is there good macroeconomic reasons to think that increased public expenditures can promote growth and poverty reduction?
- What the critical policy requirements for the expenditures to produce these benefits?
- What macroconsiderations are there about the phasing of increased expenditures?
- Would increased expenditures in fact be used to finance the PRSP or EDPRS priorities in Rwanda?
- What is the impact of the Rwanda PRGF performance on its relationships with other donors and options for development financing?
- How has the PRGF affected the national budget and medium term expenditure frameworks?
- How have sector allocations been affected?
- Quantification of fiscal space overtime in Rwanda?
- Has it increased or decreased?
- Is it constrained by quantitative conditions of the PRGF?
- What can be said about the impact of the PRGF as a lending facility? Have the benchmarks/conditions resulted in observed growth or poverty reduction? Give specific examples
- What have been the observed socio-economic impacts of the PRGF? Which sectors have been hurt? Which sectors have benefited?
- What were the challenges to implementation? What were the gains?
- To what extent have efforts been made to ensure that PRGF policies and objectives are open to public debate?
- How much room is there to increase public expenditures?
- Recent patterns of social sector (e.g. Education and health) spending in low income countries
- Trends in development aid for social sector
- How and how much does success depend upon the design of the program?
- To the extent that differences in program outcomes reflect differences in the quality of their actual implementation, why does implementation vary and how is it related, in particular, to program "ownership," or the commitment by country authorities to the policy reform package?
- Do differing economic conditions, such as the levels of external debt and reserves, influence the willingness and ability of countries, private markets, and the IMF to coordinate to achieve success?
- If a program brings an improvement in a country's economy like Rwanda, does that reflect the IMF's policy advice, its lending, its monitoring of the country's policies, or its "seal of approval" effect?

