

Rwanda: Joint Staff Advisory Note of the Poverty Reduction Strategy Paper Annual Progress Report

The attached Joint Staff Advisory Note (JSAN) of the Poverty Reduction Strategy Paper Annual Progress Report for **Rwanda**, prepared by the staffs of both the World Bank and IMF, was submitted with the member country's Poverty Reduction Strategy Paper (PRSP) or Interim PRSP (IPRSP) to the Executive Boards of the two institutions. A JSAN evaluates the strengths and weaknesses of a country's poverty reduction objectives and strategies, and considers whether the PRSP or IPRSP provides a sound basis for concessional assistance from the Bank and Fund, as well as for debt relief under the Enhanced Heavily Indebted Poor Countries (HIPC) Debt Initiative. The Boards then decide whether the poverty reduction strategy merits such support.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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INTERNATIONAL MONETARY FUND AND
INTERNATIONAL DEVELOPMENT ASSOCIATION

REPUBLIC OF RWANDA

**Joint Staff Advisory Note of the Poverty Reduction Strategy Paper
Annual Progress Report**

Prepared by the Staffs of the International Monetary Fund and
The International Development Association

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I. OVERVIEW

- 1. Rwanda's Poverty Reduction Strategy Paper (PRSP) was completed in June 2002 and discussed by the Boards of the Bank and the Fund in July 2002.** The first PRSP progress report of June 2003 was submitted to the Boards in May 2004. The second and current Progress Report that was completed in November 2004 presents the results of the PRSP implementation between June 2003 and December 2004 and gives a broad overview of policies aimed at reducing poverty through 2005.¹
- 2. Rwanda's second Annual Progress Report (APR) provides a candid review of the PRSP's implementation.** It analyzes the key elements of the PRSP, including (i) the participatory approach; (ii) priority public actions; (iii) monitoring and evaluation; (iv) institutional and governance issues; and (v) donor coordination. The overall strategy presented in the PRSP remains unchanged.
- 3. The APR highlights progress in the PRSP's implementation.** Milestones have been achieved in political and administrative governance. Local and legislative elections were successfully completed. Moreover, with the new Constitution in 2003, the judiciary became independent from the legislative and executive, and a Supreme Court was established. To enhance transparency and accountability, planning and budgeting processes necessary for the monitoring of the PRSP have improved, an organic budget law was submitted to Parliament, and an action plan to create a modern public financial management system was adopted. Most notably, the demobilization effort has advanced and strategies in the social sectors have been very successful. For example, the primary school net enrollment rate is now 91 percent and the vaccine coverage rate for all antigens varies between 80 and 95 percent in most provinces. In the health sector, the

¹ The second APR is supplemented by an update of March 10, 2005, which reports on the implementation of the PRSP during July-December of 2004.

percentage of births attended by health personnel increased by 3 percentage points and immunization rates are now at 96 percent, according to WHO/UNICEF data.

4. **The participatory approach in developing the strategies has been strengthened.** In consultations with all active stakeholders, sectoral and line ministries have developed sectoral strategies based on their research and analyses as an input to the APR. Not only did this strengthen their ownership, but it also enabled the government to focus on key issues in each sector. Complementing these efforts, the Partnership Framework for Harmonization and Alignment of Budget Support has improved the participation and engagement of donors. In particular, the government has sought to incorporate donor comments on the APR, which have emphasized the need for increased focus on output and outcome indicators, and stronger reference to sectoral strategies, particularly in the case of rural development to give the document a more forward-looking perspective. Moreover, suggestions made by staffs in the JSA of the first APR were for the most part taken into account in formulating the strategy in the second APR.²

5. **However, the APR notes that progress in some areas has been slower than expected.** Most importantly, economic growth has not picked up as the long-overdue modernization of agriculture has been lagging (in fact, the use of productivity-enhancing fertilizers declined in 2003). The APR also recognizes that fiscal decentralization and the development of appropriate monitoring and reporting systems have been advancing more slowly than expected, and that both are critical for ensuring that priorities are well targeted toward the poor. Moreover, the APR acknowledges a temporary slippage in policy implementation in 2003, when overruns in spending, mainly on elections and other goods and services led to higher-than-expected domestic borrowing by the government. This resulted in difficulties in the conduct of monetary policy. In 2004, however, macroeconomic management was broadly sound, with priority spending increasing to 8.5 percent (an increase of 1.6 percent of GDP over the 2003 level). In this context, staffs commend the government's efforts to strengthen macroeconomic policies over the past year, after the period of weak policy implementation in 2003.

6. **Staffs recommend that the upcoming PRSP update focus more on the following three areas:** (i) developing a macroeconomic framework, which clearly links the PRSP's priorities with the medium-term expenditure framework (MTEF) through costing and prioritization, and includes a debt sustainability analysis; (ii) strengthening the environment for private sector development through rehabilitating infrastructure and implementing growth-enhancing sectoral strategies, particularly in agriculture and export promotion; and (iii) better gearing public service delivery toward poverty reduction, including through decentralization and enhanced analyses linking policies to poverty outcomes.

² The Joint Staff Assessment (IMF Country Report No. 04/274) and Report No. 28350-RW (5/18/2004) for the first APR noted that it was imperative to develop and implement coherent strategies and priority programs, particularly in agriculture and infrastructure. Moreover, a clear focus was needed on increased reliance on grants financing and improving export performance.

II. MACROECONOMIC AND FINANCIAL MANAGEMENT

7. **In the staffs' view, there is a need to revise the medium-term macroeconomic framework to be more forward looking.** Such a framework is essential in particular to assist in managing potentially large donor inflows in the medium term, to ensure that the tradables sector can cope with any possible real appreciation, as well as promote the gradual mobilization of domestic revenue to prepare for an eventual reduction in these inflows. More specifically, the first APR assumed a flat growth rate of 6 percent per year over the medium term, but the recent economic slowdown would suggest that, without strong policies, Rwanda would not be able to attain these ambitious targets.³ To reduce the risk of policy errors, the staffs encourage the authorities to base their macroeconomic framework on more conservative growth projections. In this context, it is also critical to undertake further work on the sources of growth and productivity; results of the Country Economic Memorandum and the diagnostic trade integration study (DTIS) should be used as input for this exercise. Moreover, the framework should be updated to incorporate other recent developments (including in inflation and the current account).

8. **The staffs urge the authorities to incorporate a debt sustainability analysis in their framework and focus more on export promotion.** The staffs' concerns about Rwanda's capacity to carry external debt expressed in the last JSA still hold. Relative to projections made at the decision point, Rwanda's net present value of debt-to-exports ratio has deteriorated substantially and is now higher and well above the thresholds that have been established under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative. The PRSP update should acknowledge that financing to advance toward the Millennium Development Goals (MDGs) will have to be mostly in the form of grants. Moreover, to increase foreign exchange earnings, the authorities should expeditiously implement the specific actions identified in their export promotion strategy and ensure that this sector receives sufficient budgetary resources.

9. **Given limited fiscal resources and competing priorities, the authorities are putting increasing emphasis on better identifying priorities in the PRSP, and establishing a clear link to the annual fiscal budget and the MTEF.** Substantial progress has recently been made in the costing and prioritization of strategies in some sectors, particularly education and health. Much of this work is being supported by the Poverty Reduction Support Credit (PRSC). Progress has also been made in other key sectors such as energy, water, and infrastructure, where the APR outlines the agenda. However, additional work is needed in these sectors, to pull it together into an overall strategy through costing and prioritization. For example, the authorities intend to undertake much-needed and large investments in electricity sector rehabilitation over the next years, which could crowd out other priority spending. However, the APR discusses the electricity sector only briefly without mentioning the size of proposed investment plans or justifying their importance relative to other priorities.

³ This is an experience observed in other post-conflict countries, which often experience a slow down, after a decade of rapid economic growth.

III. POLICIES TO PROMOTE GROWTH AND REDUCE POVERTY

10. **High economic growth can be achieved only by making room for private sector development and advancing productivity-enhancing sectoral strategies.** The private sector will have to become the engine of growth in the medium term. The government has made progress in improving the environment for private sector development through passing legislation for the regulation of the telecommunication sector in 2001; establishing a multi-sector regulatory agency in October 2002; and establishing commercial chambers in 2004. In addition, two banks were privatized in 2004, and bids to privatize Rwandatel were launched. However, government involvement in the economy remains significant. Moreover, sectoral strategies to raise productivity and remove barriers to development must be put in place, in order to improve growth prospects. This is particularly urgent for the infrastructure, energy and agriculture sectors.

11. **While the APR rightly emphasizes the need for improved economic infrastructure, there has been little change.** Efficient transportation links, both domestic and international, are crucial for improving commerce and diversifying the economy, especially given that Rwanda is a landlocked country, suffering from high transportation costs. In particular in rural areas, the poor road network remains a major constraint for farmers to bring their produce to the market. However, progress has been limited and the government does not have a strategy to build basic infrastructure to facilitate both domestic and international trade. The staffs believe that progress in this area is paramount and urge the government to develop specific actions in the PRSP update, based on the findings of the DTIS.

12. **Staffs welcome government efforts to address the current electricity crisis.** The recently approved Urgent Electricity Rehabilitation Project will assist the government to promote: improved carbonization practices; use of improved stoves; and investments in high-priority micro hydro-based grids for rural electrification. Moreover, to reduce the importation of energy resources and mitigate deforestation, staffs welcome the government's efforts to explore alternative low-cost electricity generation, including a methane gas project from Lake Kivu, but note the need for transparency, particularly with respect to possible fiscal implications. The staffs also urge the authorities to make the necessary institutional and regulatory reforms to encourage private investment.

13. **Although the PRSP identified agricultural development as key to enhance growth, budgetary allocations to the sector have been low and specific actions still need to be developed.** While there have been some encouraging results in increasing agricultural productivity, including in the export sector, the APR candidly acknowledges that much more progress is needed. However, budgetary allocations to the agricultural sector have been decreasing as a share of GDP and the pattern of declining use of fertilizer coupled with low utilization rates for improved seeds continue to persist. Staffs fully support the planned increase in the 2005 budgetary allocation for agriculture. However, more resources will be needed. The staffs' assessment is that, without major investments in agriculture, primarily focused on rural infrastructure for marketing and trade, building the capacity of farmers and improving extension services, production will remain flat. And, if production continues to remain flat, this will also compromise food

security, particularly in the rural areas. Moreover, credit to the agricultural sector is very low, despite recent financial sector reform. Increased access to micro finance could help address this problem. Also, the new land law could open up access to credit by enhancing the role of land as a collateral. In this context, staffs recommend that government take advantage of the available support from donors in this sector to address these constraints.

14. **Action is needed now as, even if the government were to concentrate on the above sectors over the next few years, implementation will take time and results may not materialize immediately.** In this context, it should be noted that regional instability remains an obstacle to growth. Indeed, lasting peace in the region could open up the large markets in the eastern Democratic Republic of the Congo (DRC) for Rwandese companies and make Rwanda more attractive for investors.

IV. GOVERNANCE AND PUBLIC SECTOR MANAGEMENT

15. **Public service delivery will have to be more geared toward reducing poverty.** Most importantly, as an overarching problem for the entire public sector, capacity building and pay reform remain a pressing problem. Moreover, expenditure management has to be enhanced to transparently account for public resources, complemented by efforts to improve the link between policies and poverty reduction as well as better targeting to the poor through decentralization.

16. **Weak capacity in the public sector remains a key challenge.** To better coordinate capacity building interventions, the government supported by the World Bank and the Africa Capacity Building Foundation has developed the Multi Sector Capacity Building Program (MSCBP) and created the Human Resource and Institutional Capacity Development Agency (HIDA). However, concerted efforts are needed in ensuring the effective functioning of HIDA and the sound implementation of the MSCBP. Also, to underpin capacity building, the government will have to vigorously pursue pay reform to ensure adequate yet financially sustainable salary levels to attract, retain, and motivate scarce technical and managerial experts. In particular, an across-the-board increase of salary levels is neither advisable nor affordable. Instead, public sector salaries need to be carefully calibrated to private sector pay scales for workers with scarce or particular types of skills. Equally important is the need to promote transparency in the elaboration and application of pay scales, and to keep salary allowances to a minimum.

17. **To transparently account for funds spent on priorities, progress in public expenditure management needs to continue.** The APRs note that progress has been made in improving budget execution and treasury management. While welcoming this progress and acknowledging that the monitoring and tracking of debt relief is satisfactory, staffs urge the government to accelerate reforms. In particular, when preparing budgets for each sector, the links to the MTEF and the poverty reduction strategy need to be clearer. Moreover, the lack of integration of the recurrent and development budgets remains a key constraint for an effective MTEF.

18. **To establish a link between government policies and poverty reduction, the PRSP update should provide more analyses of poverty trends and outcomes,**

especially on the MDGs. Future progress reports could be strengthened by including information on poverty trends and dynamics, based on available data from the census, two core welfare indicator surveys (the 2001 and 2003 QUIBBs), and other surveys. The staffs are of the opinion that there is a need to strengthen the link between data collection, analysis (including efforts to integrate qualitative and quantitative approaches), and policymaking. For example, analytical work and indicators on vulnerability could be key inputs to the development of Government's social protection strategy. The staffs therefore recommend that the PRSP update include detailed tables of key poverty indicators with medium to long-term targets to prioritize among the key sectors of the PRSP. The soon to be established Statistics Institute as well as increasing support from donors for poverty and social impact analyses (PSIAs) should help in this regard.

19. **Decentralization of public services will help to ensure that public services are better targeted toward the poor.** The decentralization initiative has been facing inadequate funding, delayed disbursement of central government grants, weak supervision, and lack of sufficient information flow among different structures of the government. The staffs view that effective decentralization is possible only if implemented at the local government level and accompanied by efforts to build capacity in order to identify meaningful indicators and generate, analyze, and use data. In this context, the staffs welcome the proposal of the PRSP monitoring unit (Poverty Observatoire) to commence training and data collection in 8 districts, which is expected to be extended to all districts under a Poverty Reduction Strategy (PRS) trust fund (financed by Japan, the Netherlands, and Switzerland), and administered through the World Bank. In addition, financing from UNICEF and other donors is also being channeled toward PRS monitoring.

V. CONCLUSION

20. **Bank and Fund staffs believe that the APR provides a fair and candid assessment of the second year implementation of the PRSP.** The APR is comprehensive, points out risks for the future, and identifies areas for further improvement. Significant progress has been achieved in political and administrative governance. Moreover, there has been substantial improvement in outcome indicators in the health and education sectors. However, economic growth has slowed down and further efforts are needed in decentralization as well as putting in place appropriate monitoring and reporting systems.

21. **To improve PRSP implementation and ensure timely progress toward the MDGs, the staffs recommend that over the next twelve months special attention be given to:** (i) developing an overarching macroeconomic framework, which clearly links the PRSP's priorities with the MTEF; (ii) strengthening the emphasis on private sector development through rehabilitating infrastructure and implementing growth-enhancing sectoral strategies, particularly in agriculture and export promotion; and (iii) better gearing public service delivery toward poverty reduction, including through decentralization and enhanced analyses linking policies to poverty outcomes. In this regard, support from the Bank and the Fund will be forthcoming in the context of the PRSC and a PRGF arrangement.