

**Rwanda: Poverty Reduction Strategy Paper Annual Progress Report—
Joint Staff Advisory Note**

The attached Joint Staff Advisory Note (JSAN) of the Poverty Reduction Strategy Paper for Rwanda, prepared jointly by the staffs of the World Bank and the IMF, was distributed with the member country's Poverty Reduction Strategy Paper (PRSP) to the Executive Boards of the two institutions. The objective of the JSAN is to provide focused, frank, and constructive feedback to the country on progress in implementing its Poverty Reduction Strategy (PRS).

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

Approved by Sharmini Coorey and Mark Plant (IMF),
and Gobind Nankani (IDA)

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I. OVERVIEW OF THE ANNUAL PROGRESS REPORT

- 1. Rwanda's third Annual Progress Report (APR) reviews the implementation of the poverty reduction strategy (PRS) during August 2004 to July 2005.** It analyzes the key elements of the PRS, including (i) the participatory approach; (ii) donor coordination; (iii) growth-enhancing policies; and (iv) accountability and governance issues. The overall strategy remains unchanged, and the APR will be used to inform revisions of the PRS, the so-called Economic Development and Poverty Reduction Strategy (EDPRS), to be finalized in March 2007.
- 2. The APR discusses actions taken to advance toward the MDGs.** Access to health services has improved and a new health sector strategy was recently completed to address maternal and child mortality, which remain high compared with other Sub-Saharan countries. In the education sector, gross primary education (i.e. total enrollment regardless of age as a ratio of the school age population) has risen rapidly to 131 percent of the school age population and net primary school enrollment remains at 93 percent, making the target of universal primary education by 2015 feasible. The government has also made the first three years of secondary education part of free basic education. Moreover, a new Water and Sanitation Policy based on a decentralized approach was adopted in 2004 and is being implemented as evidenced by the completion of contract models and standards to assist districts in contracting private operators, and the promotion of sanitation technologies in rural areas.
- 3. The APR also reports on progress in facilitating growth and private sector development.** Strategies for the agricultural and export sectors were completed and parliament adopted the land law to strengthen property rights and registration. Moreover, steps have been taken to improve the business climate, particularly related to contract enforcement where, through the simplification of judicial procedures, the time to resolve disputes was cut by more than 20 percent and attorney fees fell by

15 percent.¹ The government also has aimed at strengthening trade by becoming an increasingly active member in COMESA and starting negotiations on the Economic Partnership Agreement with the EU as well as accession to the East African Community (EAC).

4. **Capacity constraints have slowed down reforms in financial and expenditure management as well as procurement. However, the government has started to address these.** Capacity needs assessments have been completed in all areas and discussed with donors. In addition, a training program for government accountants has started, and the law establishing the office of the Ombudsman has been gazetted. Progress has also been made in decentralization with the restructuring of administrative zones.²

5. **The APR acknowledges the need for an acceleration of structural reforms, particularly those affecting the rural poor.** Most importantly, the current average per capita growth rate of about 2 percent will not be sufficient to achieve the Vision 2020's target of halving poverty by 2020. The reporting on rural development, including on poverty reduction targets, is not comprehensive enough. The equipment of rural health centers is insufficient and the main income source for the rural poor, the agricultural sector, remains highly vulnerable to climatic and terms of trade shocks. Moreover, the APR emphasizes that the economy continues to be adversely affected by energy shortages and that trade is impeded by supply-side restrictions.

II. MACROECONOMIC AND FINANCIAL MANAGEMENT

6. **As noted in the last JSAN,³ the development effort should be embedded in a comprehensive medium-term macroeconomic framework.** While the APR presents an outlook until 2008, it lacks a clear analysis of the sources of and obstacles to growth and a link to the sectoral policies, including through costing and prioritization. Staffs also continue to be of the view that the macroeconomic framework should be based on more conservative growth projections to reduce the risk of policy errors. However, it would be useful to supplement this framework by scenarios on the downside and upside, including a scaling up of aid inflows.⁴ Moreover, while the APR rightly emphasizes the need to rely predominantly on grant financing, this should be done in the context of a long-term debt sustainability analysis, including stress tests. Staffs also urge the authorities to continue to increase the current revenue-to-GDP ratio as had been successfully done in the last years, to help reduce the dependence on

¹ Rwanda was ranked one of the top twelve reformers globally by the World Bank's 2006 Doing Business Report. However, its overall rank (139 out of 155) remains low and further reforms will be needed to reduce the cost of starting a business, estimated at 280 percent of per capita GDP.

² A Presidential decree (with agreement of Parliament) in December 2005 reduced the number of provinces from 12 to 4, and districts from 106 to 30.

³ EBD/05/30 and Report No. 31679-RW.

⁴ A scaling up scenario should analyze in particular aid absorption and capacity constraints as well as the coordination of macroeconomic policies in light of a possible appreciation of the real exchange rate.

foreign aid.⁵ Finally, while staffs welcome the planned large increase in priority spending, they note that this will entail significant cuts in nonpriority spending.⁶

7. **As the APR provides information only until early 2005, there is a need to strengthen the monitoring and development of macro-relevant policies in the interim to the EDPRS.** In particular, slippages in policy implementation such as in the third quarter of 2005 should be avoided and rectified as soon as possible.⁷ In this context, establishing a unit to monitor the implementation of macroeconomic policies would be helpful. This unit could also be involved in designing the medium-term framework for a possible new PRGF arrangement, which will need to address the issues raised in paragraph 6. Moreover, the analysis of existing data to inform policy formulation could be improved, particularly with respect to the impact of policies on poverty indicators (taking into account the forthcoming 2006 household survey and the demographic and health survey of 2005).

8. **Despite relief under the enhanced HIPC Initiative and the MDRI, the government needs to maintain its focus on debt sustainability.** Debt relief under both initiatives is expected to lower the NPV of debt-to-export ratio to about 70 percent at end-2006. However, given Rwanda's small export base and continued vulnerability to exogenous shocks, new borrowing will have to remain limited for the foreseeable future. Moreover, to increase foreign exchange earnings, continued progress on export promotion will be critical. Staffs also urge the authorities to develop a comprehensive debt management strategy, and strengthen debt management.

9. **The strengthening of the link between the PRSP and the Medium-Term Expenditure Framework (MTEFs) has advanced, but further work is needed.** Progress has been made in the costing and prioritization for the health, education, agriculture, and water sectors, and staffs are encouraged by ongoing work on a national investment plan and the authorities' plans to move toward a results-oriented MTEF. However, there may be a need to re-examine the allocations to priority sectors to ensure these are aligned with the needs of the vulnerable. For instance, almost 30 percent of priority spending went to education in 2005, while health and agriculture received only 9 and 5 percent, respectively. Efforts should also focus on the monitoring and evaluation of the pilot programs on performance-based contracts in the education and health sectors with a view to scale up the approach and expand it to other sectors, where appropriate.

III. PROMOTING GROWTH WHILE EMPOWERING THE POOR

10. **Generating high and sustained private sector-led growth is critical for reducing poverty.** Staffs emphasize in particular the importance of ensuring that the benefits of growth reach the rural areas, where the majority of the poor are located. This

⁵ The revenue-to-GDP ratio has increased from about 10 percent in 2000 to over 14 percent in 2005.

⁶ A discussion of the new car fleet policy would have been helpful in this context.

⁷ In particular, the authorities had domestic arrears of about one percent of GDP at end-September 2005. Moreover, the audit and a business plan for Prime Holdings, a government-owned enterprise, were delayed and reforms in public expenditure management stalled.

will require an improvement in the implementation of the agricultural strategy, stepping up implementation of reforms to support trade and export promotion, and addressing infrastructure bottlenecks. Staffs also note that regional instability remains an obstacle to growth.

11. **While staffs commend the authorities for making their agricultural strategy operational, the focus now has to lie on its implementation.** The food shortages in early 2006 underscore Rwanda's vulnerability to exogenous shocks and the need for productivity-enhancing measures. In this context, the Strategic Plan for Agricultural Transformation (PSTA) as well as the improvement in the budget execution of the Ministry of Agriculture is encouraging. However, human and institutional capacity building initiatives should be stepped up and there is a need to formally link the export promotion strategy with the PSTA to ensure that it does not come at the expense of food security. Moreover, progress in the implementation of the new land law is needed as this could improve farmers' access to credit by allowing the use of land as collateral.

12. **Staffs strongly recommend the implementation of the structural reforms identified in the Diagnostic Trade Integration Study (DTIS) linked to the reduction of poverty and growth of trade.** The DTIS found that trade is critical to growth and poverty reduction, and that improving rural incomes requires increasing productivity in traditional agriculture and developing nontraditional activities. While progress has been made in the traditional export sectors by moving into high quality coffee and the expected privatization of three more tea factories by March 2006, staffs underscore the importance to (i) strengthen the production and quality of traditional exports, while stepping up export diversification; (ii) promote nonagricultural employment and output; (iii) strengthen the organization of the rural sector; and (iv) remove supply constraints. Staffs urge the authorities to prioritize these policy actions and set up a monitoring system for the DTIS' implementation, which clearly outlines the roles and responsibilities of key stakeholders.

13. **Infrastructure bottlenecks are being tackled, but there is a need to focus more on rural areas, where poverty is widespread.** Overall, staffs note that the strategic planning process in the Ministry of Infrastructure needs strengthening. With respect to sectoral reforms, there have been substantial improvements in the telecommunication sector with the privatization of Rwandatel and additional satellite terminals installed in the rural areas. However, while the APR reports progress on recent efforts to rehabilitate the road network, there is no clear information on developments in rural areas. Moreover, while problems in the electricity sector are being addressed,⁸ there is a need to move toward a differentiated tariff structure and more attention should be paid to the broader issue of energy shortages in the rural areas.

⁸ As evidenced by progress toward identifying investors for the Lake Kivu methane gas project and an increase in electricity tariff rates to more closely reflect the cost of generation.

IV. IMPROVING PUBLIC SERVICE DELIVERY

14. **The last JSAN's recommendations on the need to improve public service delivery, including its focus on poverty reduction, remain valid.** In this context, staffs reiterate the need to improve public expenditure management and establish a link between government policies, and the MDGs, including poverty reduction. Moreover, in transferring responsibilities to local governments, it will be necessary to make a clear distinction between fiscal, administrative, and political decentralization as well as potential sectoral differences in the transfer of authority from the central to local governments. As weak administrative capacity is a major obstacle for the reform agenda, efforts in the areas of capacity building and civil service reform are critical.

15. **Capacity building and an appropriate incentive system will be key for civil service reform.** In line with the APR's emphasis on capacity building, the Human Resource and Institutional Development Agency (HIDA) has now taken on its role as coordinator of all human resource development and capacity development issues. However, the recent restructuring of administrative zones poses a new challenge to HIDA, including the clear definition of roles and responsibilities for service delivery. Moreover, it will be critical to retain and motivate scarce technical and managerial experts. Thus, staffs note an urgent need to undertake in cooperation with donors a comprehensive review of the entire civil service wage structure, including fringe benefits, in the context of a medium-term needs assessment.

V. CONCLUSION

16. **Bank and Fund staffs believe that the APR provides a fair and candid assessment of the third year of the PRSP's implementation.** The APR summarizes progress made over the past year and highlights areas for further improvement. Particularly noteworthy are achievements in the education, water, and electricity sectors. In addition, new health and agricultural strategies are expected to revive and refocus the momentum in these critical sectors. However, poverty still affects two thirds of the population, particularly in rural areas, and capacity constraints remain a major obstacle for reform implementation. Moreover, growth continues to be hampered by energy shortages, infrastructure bottlenecks, and barriers to trade.

17. **To accelerate reforms and advance toward the MDGs, but also in preparation for the EDPRS, staffs view the following areas as critical:**

- (i) embedding reforms in a medium-term macroeconomic framework, including a debt sustainability analysis while linking the PRSP's priorities with the MTEF;
- (ii) implementing growth-enhancing strategies, particularly in agriculture, infrastructure, and trade, to boost economic growth and empower the poor; and
- (iii) strengthening public service delivery, including through capacity building, while focusing it better on reducing poverty.