



RWANDA

POVERTY REDUCTION STRATEGY PAPER—JOINT STAFF ADVISORY NOTE

December 2013

The attached Joint Staff Advisory Note (JSAN) on the Poverty Reduction Strategy Paper for Rwanda, prepared jointly by staffs of the International Development Association 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).

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POVERTY REDUCTION STRATEGY PAPER—JOINT STAFF ADVISORY NOTE ON THE ECONOMIC DEVELOPMENT AND POVERTY REDUCTION STRATEGY 2013–18

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OVERVIEW

- Rwanda made notable achievements in sustaining high growth, reducing poverty and ameliorating income inequality during the first Poverty Reduction Strategy (2002–06) and the first Economic Development and Poverty Reduction Strategy (EDPRS 1; 2008–2013).** Economic growth and poverty reduction exceeded the targets set for the EDPRS 1. Real GDP grew at an annual average rate of 8 percent and poverty dropped from 57 percent in 2006 to 45 percent in 2011.¹ Inequality in household consumption was brought down as growth was pro-poor. Progress on social indicators is evidenced by much higher primary school completion rates (79 percent in 2011 compared to 51 percent in 2008) and lower child mortality (54 per 1,000 live births in 2011, down from 76 in 2008).
- Rwanda's second Economic Development and Poverty Reduction Strategy (EDPRS 2) covers Rwanda's fiscal years 2013/14–17/18.** It builds on the lessons learned in the implementation of the EDPRS 1. Among the positive lessons, the authorities point to the importance of ownership of the strategy including aid-financed programs, home-grown initiatives, community-

¹ Based on the national poverty line.

based solutions, the use of ICT, and an adequate institutional and legal framework. Some of the shortcomings were lack of fully articulated sector strategies, unsatisfactory coordination across sectors, insufficient involvement of the private sector, inadequate mainstreaming of cross-cutting issues, and weak monitoring and evaluation systems.

3. **The overall objectives of the EDPRS 2 are to accelerate growth and further reduce poverty, including extreme poverty.** It seeks to do so while reducing aid-dependency and thus increasing self-reliance. It aims to build on the strengths of the EDPRS 1 experience and address its shortcomings. The four thematic areas are: (i) economic transformation, to achieve high and sustained growth and restructure the economy towards services and industry, (ii) rural development, to bring the national poverty rate below 30 percent, (iii) productivity and youth employment, to ensure growth and transformation are supported by appropriate skills, and (iv) accountable governance, to improve service delivery and increase citizen participation in and satisfaction with delivery of development. These thematic areas are supported by eight foundational issues² which are long-term ongoing priorities for which substantial progress was already achieved during EDPRS 1 and seven cross-cutting issues³.

THE PARTICIPATORY PROCESS

4. **The elaboration of the EDPRS 2 involved extensive discussions and consultations with the Rwandan population, including youth, private sector, civil society, and academia.**

A communications strategy was tailored to solicit feedback and ideas from citizens from every socioeconomic category, and included a customized EDPRS 2 website, a toll-free SMS line, and country-wide road shows with brochures, banners, billboards and radio and TV shows. To ensure the broadest possible participation, two *Umuganda* days (the last Saturday of each month when all citizens engage in community work) were used to solicit citizens' views and contributions to the EDPRS 2. Focus-group discussions were held to collect grass-root level views on the most important issues. The communications strategy for the EDPRS 2 is scheduled to continue for the first two years of implementation to promote citizens' understanding and ownership of the national development agenda.

² The foundational issue areas are macroeconomic stability, demographics, food security, basic education, primary health care, rule of law, PFM, and decentralization.

³ The cross cutting issue areas are capacity building, environment, gender, regional integration, HIV/AIDS and non-communicable diseases (NCDs), disaster management, and social inclusion.

5. **Sector Strategic Plans and District Development Plans have been elaborated with tighter linkages to the EDPRS 2.** In responding to the lessons learnt from the EDPRS 1, 30 district development plans and 16 sector strategic plans, covering all districts and sectors in the country, have been developed in par with the EDPRS2. The tighter linkages between national and subnational strategies are expected to strengthen implementation of the EDPRS 2 at the level of District and Sub-District governments, which are the main implementing units.

MACROECONOMIC FRAMEWORK AND COSTING

6. **The macroeconomic framework underlying the EDPRS 2 reflects the government's ambitious growth and poverty reduction goals for the next decade.** In order to achieve middle-income status by 2020, the framework targets average annual real GDP growth of 11.5 percent between 2012 and 2020. Staffs note that attainment of the target would require a significant acceleration from the high growth levels in the last decade. Staff also note that the EDPRS 2 rightly recognizes the importance of targeting export-oriented investment in business tourism, financial services and light manufacturing. Two key challenges to attain the target are (i) the funding and implementation of public and private investment in view of prospects for declining—at least in relative terms—official external financing; and (ii) the sustainability of planned policies in light of the compression of public and private consumption that would be consistent with a re-allocation of public and private resources into investment.

7. **The staffs are of the view that, for the purposes of medium-term policy formulation, more prudent macroeconomic assumptions than those embodied in the EDPRS 2 should be used.** The government has already acknowledged the need to pursue this approach, including in the budget framework paper for 2013/14–2015/16 which assumes annual real GDP growth of 7–7.5 percent in the medium-term.

8. **The staffs encourage the authorities to more fully explore the implications, including for debt sustainability, of different funding modalities for various priority investment projects.** While Rwanda's debt sustainability outlook has been improving, it is highly sensitive to the volume of and terms on external borrowing, particularly because of the country's narrow export base. While the use of non-concessional debt could enlarge the financing envelope and provide greater flexibility to the authorities in pursuing their development goals, it would come at a cost, both in terms of a larger debt service burden and higher risks, and therefore a prudent debt management will be crucial. In this regard, the government is encouraged to continuously use its newly developed debt management strategy to monitor Rwanda's debt sustainability prospects.

9. **The staffs are also of the view that domestic revenue mobilization should play a larger role in financing public investment envisaged under the EDPRS 2.** The macroeconomic framework envisages only a modest increase in the revenue-to-GDP ratio and the EDPRS 2 is largely silent about how this is to be achieved. In fact the strategy emphasized the need to preserve investment incentives under the current tax system. The staffs encourage the government to further explore options to broaden the tax base and lower tax expenditure, especially in the context of

uncertain aid inflows. Moreover, as the EDPRS 2 progresses, expenditure prioritization should be under continuous review.

THE THEMATIC AREAS, FOUNDATIONAL AND CROSS-CUTTING ISSUES

A. Economic Transformation

10. **Economic transformation to a more industrial, diversified, and high productivity urban economy aims to sustain rapid growth.** The EDPRS 2 identifies a catalytic role for the public sector in private sector-led growth in the following five areas (i) increasing domestic interconnectivity through investment in infrastructure; (ii) increasing external connectivity and boosting exports; (iii) transforming the private sector through investment in priority sectors; (iv) transforming the economic geography of Rwanda by facilitating urbanization and promoting secondary cities; and (v) pursuing a green economy approach. In transforming the private sector, for example, the EDPRS 2 proposes to strengthen investment processes targeting large foreign investors, accelerate structural changes in the financial sector and strengthen the business environment. Also, as a means to leverage private sector-led growth, it emphasizes the importance of public-private partnerships.

11. **Staffs agree that the private sector will have to play a key role in the acceleration of growth and poverty reduction, however challenges remain.** Over the past five years, improvements in the investment climate have not been associated with a significant increase in private investment, which means the cost of doing business is still too high. The Economic Transformation theme aims to drive down this cost by removing key bottlenecks in infrastructure and energy. Staffs welcome this focus. In addition, while the EDPRS 2 defines the role of the public sector as a catalyst for private sector-led growth, performing this role will require significant financing. In this regard, staffs recommend that the Government prioritizes its investment programs while taking into account proper sequencing and linkages between them, as well as to ensure that adequate financing is available for private investment.

B. Rural Development

12. **Staffs commend the government for its continued focus on reducing poverty through the social protection priority area articulated in the EDPRS 2.** In particular, it is encouraging to see that a pilot social protection program designed for EDPRS 1 (the Vision Umurenge Program⁴)

⁴ The Vision Umurenge Program is Rwanda's flagship social protection programs developed for EDPRS1. It provides vulnerable persons with a mix of cash transfers, employment in public works and access to credit.

has been scaled up in recent years and will continue to be expanded to double its coverage by the end of the EDPRS 2 period. Staffs agree that the targeting mechanism for the social protection programs should be improved by using available district-level poverty data. In addition, substantial efficiency gains can be made by targeting administrative units below the districts. Staffs suggest that the authorities use the 2012 census data to optimize targeting of resources to lower-level administrative units such as sectors or cells based on unit-specific poverty estimates. This would likely increase the return on the social protection programs in terms of poverty reduction and contribute to the achievement of the ambitious poverty goals set forth in the EDPRS 2.

13. **As Rwanda's strong poverty reduction over the past five years has largely been driven by developments in agriculture, staffs welcome the continued focus on agricultural productivity and infrastructure in the EDPRS 2.** As pointed out in the EDPRS 2, the move from subsistence to commercial agriculture will entail a shift towards higher-value crops, which require specialized technical know-how and value-chain expertise. Also, the EDPRS 2 emphasizes the importance of harnessing the potential of the private sector for achieving greater productivity and incomes in agriculture. Specialized agricultural skills are also needed to make land more productive, especially given the small average size of landholdings, and create linkages to markets and generate non-agricultural jobs. While both the EDPRS2 and the Strategic Plan for Agricultural Transformation (PSTA 3) acknowledge the importance of specialized agricultural skills, both remain vague on how the appropriate skills will be developed. Staffs encourage the government to elaborate a detailed strategy for the development of agricultural skills.

C. Productivity and Youth Employment

14. **The focus on improving skills and ensuring that the education system produces the right skills is important and appropriate.** Staffs agree with the need to review educational curricula to obtain a closer match between the skills produced by the educational institutions and those actually required on the labor market. Until recently, collaboration between the private sector and educational institutions has been limited and selective. This collaboration is however critical for meeting labor market demand and avoid unemployment among skilled graduates. Staffs therefore commend the recent establishment of sector skills councils where employers and educational institutes are represented.

15. **The EDPRS 2 acknowledges small informal non-farm businesses (micro-enterprises and household enterprises) as a major source of jobs in Rwanda.** The importance of these businesses is likely to grow in the coming years, given the observed transition from farm to non-farm activities and the sharp increase in the number of working-age adults. The EDPRS 2 aims to improve the business environment for small informal businesses to promote their growth and profitability and facilitate their entry into the formal sector, but remains vague on the actual strategy to do so. Staffs encourage the Government to design a solid strategy for the development of the micro-enterprise sector, taking into account the growing body of evidence on the kinds of interventions that are successful in facilitating the growth and formalization of small informal-enterprises (for instance through the Bank's Finance and Private Sector Development' Impact Evaluations).

D. Accountable Governance

16. **The staffs welcome the EDPRS 2 focus on promoting citizens' empowerment and participation and improving public service delivery.** While staffs commend the far reaching reforms carried out by the government to restructure and modernize the public service, further reforms will be needed as the government seeks to diversify the economy and achieve private sector-led growth. A discussion of the changing requirements of public service and further reform efforts as the economy continues to grow and approach middle-income status is absent. The government will need to articulate clearly where the priority focus will be in the medium term as regards strengthening the capacity of different levels of Government. Given the ongoing decentralization process, local levels of Government will likely become the frontline of accountability. As such, staffs recommend focusing capacity strengthening efforts on local entities. In addition, the staffs note that compared with the EDPRS 1, the EDPRS 2 is silent with regard to the protection of human rights.

17. **The preceding EDPRS led to substantial institutional restructuring and reconfiguration.** The EDPRS 2 would benefit from more attention to second-generation reforms around systems strengthening in government, particularly to improve systems of human resource management with a view to attract and retain talent. These reforms will be important in improving and maintaining capacity of the public sector and enhancing service delivery.

FOUNDATIONAL AND CROSS-CUTTING ISSUES

18. **The staffs welcome the focus in the EDPRS 2 on mainstreaming capacity building in all the sector strategic plans and district development plans.** However, the prominence of capacity building issues varies across sector strategies and some sectors have not articulated their medium-term priorities and needs in any depth. It will be important for the National Capacity Building Secretariat (NCBS) to enhance its facilitation and support to all the priority sectors (energy, agriculture, private sector development, environment and natural resources, urbanization and transport) to undertake capacity building diagnostics and to design the proposed sector capacity building plans throughout the EDPRS 2 period. In addition, staffs encourage central government institutions such as the Rwanda Governance Board, the NCBS, the Ministry of Public Service, the Ministry of Finance and Economic Planning, and the Ministry of Local Government, to work together with sub-national governments to improve their capacity. This will be particularly important in light of the important role in service delivery performed by decentralized entities and their relatively weaker administrative capacity.

19. **The staffs welcome significant progress on public financial management (PFM) and encourage further reform efforts.** The staffs acknowledge that the Public Expenditure and Financial Accountability (PEFA) assessment evidenced significant improvement of the PFM system in Rwanda. However, at the same time, the assessment identified remaining weaknesses in the areas of accounting, recording and reporting. Therefore, the staffs encourage the government to further emphasize reforms in those areas. As the EDPRS 2 rightly notes, PFM is the platform for the efficient

management of the nation's resources and further improvements in this area will be key for realizing EDPRS 2 goals.

TARGETS, INDICATORS AND MONITORING

20. **Progress towards EDPRS 2 targets will be tracked through a national monitoring and evaluation framework.** The framework consists of a monitoring matrix containing a priority set of thematic and foundational indicators with clear targets. These indicators will be monitored on an annual basis. Staffs commend the decision to limit the number of indicators by focusing on key ones, as this will increase the usefulness of the new national monitoring matrix in tracking progress and reduce the reporting burden put on decentralized entities. The creation of an electronic and fully integrated monitoring and evaluation (M&E) system is likely to alleviate some of the difficulties experienced during the EDPRS 1, most notably related to limited capacity at the district level. To enhance M&E capacity at the local level and avoid reporting delays due to low capacity, staffs encourage the National Institute of Statistics to be proactive in building M&E capacity at decentralized levels.

21. **Rwanda is to be commended for its systematic program of census and survey data collection.** To monitor progress towards development objectives, the main surveys that produce data on poverty and social indicators (the Integrated Household Living conditions Surveys and the Demographic and Health Surveys) have been implemented at regular intervals, with the next rounds scheduled to take place in time for final reporting on the MDG targets and evaluation of the EDPRS 2. Rwanda has also made great strides on the openness and transparency of data by launching an open data platform where micro-level survey data can be readily downloaded. This initiative remains however under-utilized due to limited domestic capacity in data manipulation and analysis. Staffs recommend exploring measures to expand the pool of qualified data users in the country and to build analytical capacity both within the NISR and the broader research community. Also, there is currently a large discrepancy between the poverty headcount based on the national poverty line (45 percent) and the one based on the international poverty line (63 percent). As the national poverty line has been estimated in 1999/2000, staffs recommend estimating a new national poverty line upon completion of the 2013/14 Integrated Household Living conditions Survey.

RISKS

22. **The main internal risks to growth and poverty reduction arise from variable climatic conditions and the private sector response to government reforms.** Agriculture is the main employer and driver of poverty reduction but remains vulnerable to the vicissitudes of unpredictable weather patterns and regional droughts and floods, which can significantly affect output and progress on poverty reduction. Stepping up measures to make agriculture more climate-resilient, for instance through the construction of irrigation facilities and terracing which the Bank is supporting, will be important for attaining EDPRS 2 targets. In addition, the important role given to the private sector in the EDPRS 2, while appropriate in staffs view, is challenging given the modest performance

of the private sector over the past years. As the private sector will have to play a critical role in achieving the ambitious targets elaborated in the EDPRS 2, Staffs encourage the government to step up efforts to create a more conducive environment for private sector development, including through improved access to finance and further reductions in logistic and other costs of doing business in Rwanda.

23. **The main external risks relate to the pace of regional integration and the potential for regional conflict, more-rapid-than expected tapering of donor inflows, and a prolonged slump in the global economy.** As a landlocked country, Rwanda depends crucially on closer integration with its neighbors to facilitate imports and exports and drive economic growth. While strong progress on regional integration could drive economic growth across the region and boost regional stability, renewed tensions and conflict could stall integration, adversely affecting Rwanda's plans to become a regional hub as well as donor flows, with adverse implications for growth. Rwanda's high reliance on foreign aid makes its development strategy vulnerable to reductions in aid flows. While Rwanda is fairly insulated from the global economy a prolonged slump would nevertheless have a negative impact on growth prospects through lower demand for goods and services, as well as through more constrained availability of external financing.

CONCLUSIONS

24. **Fund and Bank staffs believe that the EDPRS 2 provides an adequate framework for development and poverty reduction in Rwanda.** The strategy builds on lessons learned in the implementation of the EDPRS 1 and lays out a clear strategy for economic transformation, growth and poverty reduction based on thematic priorities supported by continued attention to foundational and cross-cutting issues with strong emphasis on the roles of the private sector.

25. **The staffs recommend the following actions to strengthen implementation of and reduce risks in the EDPRS 2:**

- Explore options for strengthening domestic revenue mobilization to support investment priorities.
- Apply proactively the debt management strategy to assess the implications for the debt sustainability outlook of different financing scenarios.
- Closely monitor response of the private sector to government policies, and adjust them accordingly.
- Prioritize and sequence public investment programs taking into account the need to ensure adequate financing for private sector investments.
- Further improve human resource and public financial management systems with a view to increase expenditure efficiency and enhance service delivery.

- Step up capacity building efforts at decentralized levels to strengthen local administrative capacity and improve local service delivery.
- Closely monitor and update macroeconomic assumptions as necessary.
- Prepare contingency plans that preserve priority spending if adjustment becomes necessary.