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Growth and Poverty Reduction: Evaluating Rwanda's First PRS

Foreword

This study on Rwanda is part of a series of annual studies, undertaken by various Swedish universities and academic research institutes in collaboration with Sida. The main purpose of these studies is to enhance our knowledge and understanding of current economic development processes and challenges in Sweden's main partner countries for development co-operation. It is also hoped that they will have a broader academic interest and that the collaboration will serve to strenghen the Swedish academic resource base in the field of development economics.

This report has been prepared by Arne Bigsten and David Yanagizawa at the Department of Economics at the University of Gothenburg. Its focus is on the issue of economic growth, the development of the productive sectors and the constraints to growth, against the backdrop of the aspirations laid down in the country's Poverty Reduction Strategy.

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1. Introduction

The economic history of Rwanda can be divided into the period before and after the genocide in 1994. Apart from its horrendous human consequences, it led to a huge drop in economic activity. The period since then has been a period of reorganisation and recovery. Once the rebound effect peters out, it will be harder to sustain growth rates at current levels.

Rwanda published its first Poverty Reduction Strategy Paper (PRSP) in 2002, and has since then followed a Poverty Reduction Strategy (PRS). Now the government of Rwanda is in the process of preparing the evaluation of the three years of experiences of the PRS built on PRSP1, and it is also preparing a roadmap for the formulation of PRSP2 that builds on the current experiences and outlines the future strategy. Against this background our report will try to contribute to the ongoing discussion and thereby hopefully support the ongoing work.

The focus of this report will be on the issues of growth, the development of the productive sectors, and the constraints of growth. It will be more concerned with structural than short-term macroeconomic stabilisation issues. The report covers the following aspects:

Syndromes, Poverty Traps, and Development Policy: Here we put the case of Rwanda in the context of the ongoing academic discussion about Africa's growth and poverty problems.

Rwanda in a comparative perspective: This section provides a background to the discussion about current events. It compares the situation in Rwanda with that of neighbouring countries and Sub-Saharan Africa and how its relative position has changed since 1965.

Rwanda's first PRSP: This section describes briefly the diagnosis of poverty in the first PRSP and its growth framework.

Economic performance: The first sub-section presents growth decomposition for Rwanda covering the period from 1960 to 2000. The remainder of the section reviews the economic outcomes in recent years in greater detail, in particular macroeconomic development, sector development, the external sector, and government revenues and expenditures.

Programme implementation: The six priority areas of the PRS are (1) agriculture, (2) education and health, (3) economic infrastructure, (4) human resources and capacity building, (5) private sector development, and (6) governance, institutional reforms, and accountability. Since we particularly want to relate to the growth framework set out in the PRSP, we structure our discussion of programme implementation so that the relevant aspects of the growth analysis are also covered: We first discuss macroeconomic policy and relate this to the issue of aid coordination. Then we review the strategy implementation with regard to agriculture in particular and then private sector development in general followed by discussions about the key aspects of investment and exports. The following sections deal with the issue of human development (health and education) and economic infrastructure, while the last section discusses the issue of governance, in particular the budget process and the poverty monitoring process.

Poverty outcome: A solid analysis of the results of the PRS in terms of poverty change cannot be done at present, since there is a lack of current household data. Still, we present a back-of-the-envelope calculation of poverty change since 2000 and give at least a range of the likely outcome for 2004.

The Future of the PRS: In this section we try to draw some conclusions about the road ahead on the basis of our discussion. We start by commenting on the implementation of PRSP1 and on the extent to which the PRS-process is country-owned. Then we summarize our conclusions with regard to the growth prospects of Rwanda. Finally, we draw some conclusions about the road ahead for the PRS work and discuss the design of the forthcoming evaluation of the PRS-experience as well as PRSP2.

Concluding Remarks: Here we briefly sum up the main points of the report.

2. Growth Syndromes, Poverty Traps, and Pro-poor Growth

Poverty in Africa has increased over the last few decades, while it has declined in the rest of the World (Chen, Ravallion, 2004). The main reason for the dismal result of poverty reduction efforts is poor growth. Per capita incomes in Sub-Saharan Africa fell by 8 per cent between 1972 and 2002. In a famous paper Easterly and Levine (1997) referred to the African experience as the "African growth tragedy".

The most ambitious study trying to explain African economic growth, or rather the lack thereof, has been undertaken by the African Economic Research Consortium (O'Connell, 2004, Collier, O'Connell, 2004). The project has attempted first to identify the growth opportunities and constraints and then to explain the success or failure of countries in seizing the opportunities. The study characterizes opportunities for growth along two structural dimensions. The first dimension divides countries into three geographical categories, namely coastal countries, landlocked countries, and resource rich countries (irrespective of location). The second dimension is the degree of polarization in the society, from not polarized to moderately polarized and highly polarized countries. In this structure Rwanda would be characterized as a landlocked and highly polarized country.

When looking globally at the performance of landlocked countries, Collier and O'Connell 2004) find strong evidence that resource-scarce landlocked economies have dramatically worse opportunities for growth, and that there were two basic mechanisms behind this. First, being landlocked implies high constraints on market access, which had the effect that manufactures were precluded from significant entry into the global market. Second, without high-value resources, landlocked countries were left dependent upon agriculture. There is no example of any such a third world country experiencing rapid growth during the period of 1960–2000.

The main conclusion of the AERC study is that African growth has faltered due to dysfunctional political-economic configurations or syndromes. Africa's poor growth performance is not the product of a uniform phenomenon but due to interaction different syndromes with different effects in different countries with different opportunities. It is noteworthy, though, that in the 1990s the landlocked natural resource scarce countries were the most successful ones in breaking free of the syndromes. Collier and O'Connell believe that because of the small upside potential for land-locked countries such as Uganda (and Rwanda for that matter), these countries may be more resilient to policy errors and predation. For example, peasant farmers have the option of retreating into subsistence farming to protect their incomes, if the government tries to exploit them. These types of countries may therefore be less prone to the syndromes than what otherwise would have been the case. Rwanda's recent good growth performance is at least consistent with this conclusion.

An alternative characterization of the African growth problem is the notion of a poverty trap. In his work on the UN Millennium project Jeffrey Sachs et al (2004) argue that Africa is caught in a poverty trap, and that therefore small changes are not enough. He argues that African countries will not be able to break out of the poverty trap unless large-scale foreign assistance is injected into the system. What is needed is an investment strategy alongside international changes in policies and governance structures. Whether the African economies are able to effectively absorb a large aid increase is a hotly debated issue in this context. The MDG policy package advocated by Sachs focuses very much on health, education, and agriculture and this resembles very much Rwanda's PRS. Moreover, Rwanda is already receiving large amounts of foreign aid to help finance investments in these sectors. We will obviously need to discuss the absorptive capacity of the Rwanda government.

The main development target for Rwanda is poverty reduction. Changes in poverty depend on growth and changes in income distribution, which in turn depend on the policies pursued. The elasticity of poverty with regard to both growth and changes in income distribution vary by the extent of initial inequality. Thus the change in poverty is a function of growth, initial distribution, and change in this distribution. Both growth and inequality elasticity of poverty are increasing functions of per capita income and decreasing functions of the level of inequality, which means that the optimal growth-distribution policy mix will vary across countries (Bourguignon, 2004). Changing the distribution is more important in better off and highly unequal societies, while growth is relatively more important for poverty reduction in countries with low average incomes and low inequality. Rwanda is an intermediate case having low per capita incomes but fairly high levels of inequality. From the perspective of poverty reduction one can thus argue that Rwanda should have a strong focus on growth, but that distributional aspects also need to be considered.

3. Rwanda in a Comparative Perspective

3.1 Socio-economic standards

Before embarking on the analysis of the growth constraints of Rwanda, it may be useful to look at its historical development and to compare the situation in Rwanda with that of other countries. Most regions of the world have experienced considerable economic growth during recent decades, while per capita incomes in Africa is lower now than it was in the 1970s. Africa as a continent is thus further behind the rest of the world than it has ever been. We will not compare Rwanda to the rest of the world but provide some comparisons to some countries in the region and Sub-Saharan Africa (SSA) with and without South Africa.

When it comes to comparisons of per capita income levels, Rwanda is in a very special situation due to the devastating impact of the genocide in 1994. Still, Rwanda comes out reasonably well in a comparison with its neighbours, and is actually ahead of Tanzania and not that far behind the average for SSA excluding South African (Table 3.1). The country has by now made up for the drop in income caused by the genocide, but it is still poorer than in the early 1980s.

Table 3.1: GDP per capita (Constant 1995 US$)

	1965	1970	1975	1980	1985	1990	1995	2000	2002
Rwanda	213.98	263.21	233.21	321.10	311.36	291.97	227.08	267.29	294.66
Burundi	126.91	164.69	161.60	176.21	197.81	206.30	162.51	139.01	143.08
Kenya	202.18	225.95	300.67	337.43	319.88	357.99	338.97	328.44	322.16
Tanzania	..	..	..	..	..	188.77	177.27	191.75	207.14
Uganda	..	..	..	..	220.43	236.30	283.91	338.89	359.06
Sub Saharan Africa	539.01	606.67	655.87	647.52	593.05	585.16	552.09	572.37	580.50
SSA excl. S. Africa	294.53	316.99	337.28	338.97	315.97	323.86	312.91	333.30	338.33

Source: World Bank Africa Data Base 2004

What can we say about other dimensions of welfare using the same data base? Life expectancy at birth in Rwanda (39.8 years) is the lowest in the region and much lower than it was in 1985 (47.5 years). One common reason for low life expectancy in Africa is the high infant mortality rate, but for the case of Rwanda the reason seems to be high and increasing adult mortality.

We can also compare access to social services such as education and health services. With regard to access to primary education Rwanda does well relative to its neighbours, and with the educational reforms the gross enrolment rate is now even over 100%. With regard to expenditure on health services Rwanda is at par with Tanzania and not far below SSA excluding South Africa.

Overall, the data suggest that the social and economic standard of Rwanda is somewhat below those of SSA excluding South Africa. The main negative factor is the low life expectancy. Considering the atrocious history that the country has seen and the problematic location far from the sea, the situation is not as bad as one might have feared.

3.2 Economic structure

Let us next consider some dimensions of economic structure that tend to be correlated with levels of income. The first indicator we consider is the share of agriculture in GDP. If we take this as an indicator of modernization or development Rwanda at about 41% is far behind SSA, again at par with Tanzania (Table 3.2). The share of production that originates in agriculture is the same as in 1985, as is the income level. If we consider employment shares instead the concentration to agriculture is very much higher. Among females more than 97% of the active labour force was in agriculture in 1990, while 86% of active males were in agriculture the same year. Rwanda is thus to an exceptionally high degree agricultural. The only country in Africa that reports a higher share of males in agriculture is Burkina Faso.

Table 3.2: Agriculture as share of GDP,%

	1965	1970	1975	1980	1985	1990	1995	2000	2002
Rwanda	74.79	61.62	49.21	45.85	41.84	32.55	44.00	41.41	41.41
Burundi	..	65.33	61.30	57.57	55.95	51.06	42.04	45.01	43.14
Kenya	32.42	30.17	30.17	27.79	28.52	24.97	26.35	16.99	14.42
Tanzania	..	..	..	..	48.94	42.05	43.65	41.56	41.18
Uganda	49.07	51.03	70.62	71.76	48.38	53.28	45.30	34.20	28.90
Sub Saharan Africa	31.65	26.27	25.07	20.19	23.85	19.49	17.07	17.57	20.21
SSA excl. S. Africa	39.96	34.13	31.92	26.47	31.50	28.77	29.14	26.99	28.26

Source: World Bank Africa Data Base 2004

Another indicator of modernization is the extent of financial development as measured by money supply relative to GDP. Rwanda is the least monetized economy in the region and considerably below general SSA levels. This indicates that Rwanda is a poorly integrated economy, where subsistence production is highly important.

Other indicators of the modernity that are easily available are for example the number of telephones (although mobiles is replacing the fixed system rapidly), television sets and internet usage. The telephone density in Rwanda is very low compared to most of Sub-Saharan Africa, and the television density is incredibly low. The estimated number of internet users in 2002 was only 25000, which shows that the highly ambitious plans for the internet so far has not had much of an impact. It seems very clear that Rwanda is a country that at least in terms of these types of communication attributes is not linked up to the rest of the world. Globalisation seems largely to have passed Rwanda by.

3.3 Investment and savings

A key determinant of economic growth is investment. Table 3.3 shows that as a share of GDP Rwanda is on the Sub-Saharan average, and that it does better than the other countries in the region except Uganda. So the level of aggregate investment is quite satisfactory. We see here that investment activity has recovered from the genocide drop. We would also argue that long-term sustainable growth requires private investment. The private investment share has developed well (12% of GDP in 2002), and that private investment is actually a larger share of gross domestic fixed investment than public investment. This augurs well for the future, but we will discuss this issue more below.

Table 3.3: Gross domestic investment as share of GDP (%)

	1965	1970	1975	1980	1985	1990	1995	2000	2002
Rwanda	9,81	7,05	13,74	16,14	17,31	14,65	13,41	17,53	18,82
Burundi	5,77	4,53	7,58	13,89	13,86	14,54	9,58	9,09	7,88
Kenya	14,39	24,40	18,14	24,51	22,13	19,70	17,53	15,39	13,59
Tanzania	..	..	..	..	..	26,11	19,79	17,63	16,70
Uganda	11,24	14,00	8,05	6,15	8,73	12,70	16,42	19,80	21,67
Sub Saharan Africa	18,61	20,17	25,49	23,47	15,72	16,38	18,16	17,50	18,89
SSA excl. S. Africa	15,32	16,97	23,55	20,55	13,77	15,86	18,32	18,77	20,39

Note: Gross capital formation (gross domestic investment) consists of outlays on additions to the fixed assets of the economy plus net changes in the level of inventories. Fixed assets include land improvements (fences, ditches, drains, and so on); plant, machinery, and equipment purchases; and the construction of roads, railways, and the like, including schools, offices, hospitals, private residential dwellings, and commercial and industrial buildings. Inventories are stocks of goods held by firms to meet temporary or unexpected fluctuations in production or sales, and "work in progress." According to the 1993 SNA, net acquisitions of valuables are also considered capital formation.

Source: World Bank Africa Data Base 2004

For growth to become sustainable one also wants to see that it increasingly is financed by domestic savings, but this has not yet happened in the case of Rwanda. Gross domestic savings are around one percent of GDP, while foreign savings makes up some 20% of GDP. Essentially the whole investment budget is foreign financed.

Another feature of the economy that is important for the efficiency in the allocation of investment resources is the functioning of the banking system. Again we would like it in particular to channel resources to the private sector in an efficient way. The bulk of its lending is actually to the private sector, while the public sector generally does have to use to banking system to fund its expenditure, being well provided with money directly from the donors.

3.4 Exports and foreign investment

Our second main area of concern when it comes to creating a basis for long-term sustainable growth is exports and foreign direct investment. This is clearly a critical area and very problematic for Rwanda. Again it is clear that Rwanda is not really integrated into the global economy. Rwanda earned 219 million US$ in 2002 from export of goods and non-factor services. This export revenue only constituted 7.65% of GDP (Table 3.4). The only country in Africa that is less outward oriented is neighbouring Burundi. So Rwanda stands out as being one of the most inward-oriented countries in the world, at the same time as the only viable way forward to such a small economy with limited land resources is to trade more. This is a grim conclusion considering that Rwanda has international transport costs that are extremely high. To build an efficient transport system that provides access to the international market seems to be a key priority for the long-term development of the country. Some items can be flown out, though, if the air transport system including cooling facilities at the airport is appropriate.

Table 3.4: Export. of goods and non-factor services as share of GDP (%)

	1965	1970	1975	1980	1985	1990	1995	2000	2002
Rwanda	12,10	11,51	9,17	14,44	10,78	5,61	5,15	8,26	7,65
Burundi	10,35	10,69	8,28	8,81	11,03	7,87	12,93	9,16	6,57
Kenya	31,40	29,83	29,82	27,95	25,31	25,85	32,59	26,27	26,61
Tanzania	..	..	..	..	7,30	12,62	20,73	14,39	16,66
Uganda	25,58	23,35	8,65	19,44	13,74	7,24	11,79	11,26	12,02
Sub Saharan Africa	23,41	20,93	23,73	31,04	25,08	26,45	28,47	34,15	33,86
SSA excl. S. Africa	22,41	20,95	22,26	29,17	22,57	27,67	33,40	37,70	33,73

Source: World Bank Africa Data Base 2004

The commodity export from Rwanda is essentially made up of agricultural goods and natural resources. Manufacturing exports are virtually non-existent. The total amount earned is around one million dollar per year! Among service exports we have tourism, but Rwanda is a very marginal destination. There is some scope for improvements here, but the unique attraction which is the gorilla parks cannot carry so much visitors. Alternatives are so far limited, but they can be developed. So both goods and services exports are tiny. An alternative way to attract private money into the economy is via direct investment, but the inflows are virtually non-existent. The inflows that are there are related to the privatisation of government corporations. Apart from that Rwanda is clearly not on the radar screen of foreign investors.

What remains to seek out when export revenues and foreign investment does not suffice is development assistance. Here Rwanda stands out and receives very large amounts of foreign aid with flows in 2002 constituting more than 20% of GDP. The only countries in Africa that were more aid dependent in 2002, were Burundi, Eritrea, Ethiopia, Mauritius, Mozambique (top of the list at more than 50%), and Sao Tome.

So donors have been generous, but some of the aid has been in the form of loans, which has contributed to the build up of a large stock of foreign debt. As a share of GDP it is still slightly less than the average for Sub-Saharan African excluding South-Africa. However, the unique aspect of Rwanda's (and Burundi's) foreign debt is that it is huge relative to export revenue. Again, Rwanda stands out as an extremely inward oriented country, and this suggests that it will have a very hard time to handle the debt issue on the basis of its own foreign incomes. The HIPC write-offs will help a bit, but the question is whether they will be at all sufficient for Rwanda.

3.5 Characterizing Rwanda

Africa stands out as the continent that has the most of poverty of all continents, and over the last three decades per capita incomes have declined significantly. The per capita income level in Rwanda is slightly below the average for SSA excluding South Africa, so the country is poor but not extremely so by African standards.

Rwanda is extremely agriculturally dependent, more so than practically any country on the planet. Subsistence production is still very important, but it seems as if agricultural productivity has developed reasonably well in recent years. The share of agriculture is GDP or employment is a useful indicator of how far structural change has proceeded. The share of agriculture is falling fast in Asia, while in the case of Rwanda it is very high and has not fallen since the 1980s. This is an indication that a self-sustaining development process is not underway yet.

The bulk of investment seems to be in the private sector and most of the bank lending goes to the private sector, since the public sector is well provided with foreign aid. But how well does the private sector use this money? Are there good investment opportunities outside real estate and trading? Gross domestic savings is virtually zero, which means that the whole investment activity is financed by foreign savings.

There is a low degree of modernization and the country poorly integrated with the world economy. Rwanda has not been able to link up to the globalisation process that is going on in the world, and unless it manages to do this is unlikely to break out of the poverty trap it finds itself in.

4. Rwanda's First PRSP

4.1 The diagnosis of poverty

PRSP1 defined individuals as poor if they are confronted by a complex of inter-linked problems and cannot resolve them, do not have enough land, income or other resources, and as a result live in precarious conditions, unable to satisfy basic needs including food, clothing, medical costs, children's schooling etc. Two poverty lines were established. Households are deemed to be poor if their total annual expenditure is less than 64,000 Rwf per adult equivalent in 2000 prices, and they are deemed to be in food poverty if their expenditures fall below 45,000 Rwf per adult equivalent per annum. At the time of the first PRSP 60.3% of the population of 7.98 million was estimated to live below the total poverty line. Using a somewhat different definition, the percentage of the population in poverty in 1985 was 45.7%, while the figure had soared to 77.8% after the genocide in 1994.

Urban and rural poverty

The most obvious regional gap in poverty is the extreme one between Kigali-urban and the other provinces. The incidence of poverty in urban-Kigali population was 12.3%, compared to the national average of 60.3%. In terms of real expenditures of households 75% of people in Kigali-urban were in the top quintile for the country, while the poorer provinces like Gikongoro and Kibuye only had 7.2% and 9.9%, respectively, in the top expenditure quintile. Gikongoro had the highest percentage of population in the lowest quintile of the country at 32%.

As much as 96% of the food-poor lived in the rural areas. The connection between rural poverty and agricultural productivity is very strong, and the high level of poverty in rural areas is largely due to the failure of past agricultural policies. More specifically, this has resulted in a rapid decline is soil fertility, low levels of agricultural extension and veterinary services, and a very low degree of commercialisation. The PRSP notes that rural poverty is prevalent because of the absence of market centres, price fluctuations, and lack of credit.[1]

Due to a lack of small and medium-scale enterprises, and only small manufacturing activity, alternative non-agricultural income sources and employment opportunities are scarce, and many are left with the only

[1] For example, 69% of micro-enterprise financing comes from either own savings of the sale of assets. Only 2.6% is financed through loans from financial institutions, NGOs or employers.

option of subsistence farming. About 90% of the working population are employed in agriculture; almost all of them classified as self-employed or unpaid, signalling that the overwhelming majority is family members engaged in family farming. Moreover, there are few secondary activities, and although different estimates suggest that the rural underemployment is significant, only 1% of the labour force in the rural areas was openly unemployed, as compared to 4% in urban areas. Factors such as higher growth, increased productivity and more export from agriculture are recognized as crucial for poverty reduction.

Inequality

The Gini-coefficient had risen from 0.29 to 0.45 from the mid-1980s to the time of the first PRSP (see Section 7). This is a very large increase, although the figure for the 1980s seems suspiciously low for an African economy. The level of inequality was also reflected in the average expenditure per adult equivalent. The poorest quintile had real expenditures of 21,106 Rwf, while that of the richest quintile was almost ten times higher at 200,462 Rwf per year. The PRSP distinguished six categories of households, where the poorest were in the category Umutindi nyakujya, those in abject poverty. The characteristic of Umutindi nyakujya is that they need to beg to survive, have no land or livestock, lack shelter, adequate clothing, and food. They often fall sick and have no access to medical care. Their children are malnourished and the families cannot afford to send them to school. The richest, Umukire, have land, livestock and often salaried jobs. They also have good housing, often own a vehicle and deals with the banks in both lending and borrowing.

Health

The first PRSP recognized that poor health is both a cause and a consequence of other dimensions of poverty. The genocide had a detrimental effect on the level of health. In the pre-genocide years 1986–1990, 140.5 children per 1000 died before reaching 5 years of age, while that number had risen to 196.2 in the post-genocide years of 1996–2000. The health deterioration was also evident with regard to the prevalence of HIV-infections, which rose from a 1.3% rate in rural areas in 1986 to 10.8% at the time of the first PRSP.[2] Life expectancy was reported to be 49 years (considerably higher than the figure reported by the World Bank – see section 3) and the number one cause of morbidity was malaria, followed by intestinal parasitosis and respiratory illnesses. Mosquito nets, which significantly lower the risk of malaria, were widespread in urban areas but scarce in rural ones. A third of children in urban areas sleep under net, while only 2% of the rural children do so.

The poor health condition had also been accompanied by gradually lower utilisation of health services, even though the level was low already to begin with. For example, between the years of 1998 and 2000 the utilisation of curative services, as measured in new cases per inhabitant and year, decreased from 0.34 to 0.26. The PRSP points to several reasons for people's difficulty of accessing health care. First, the *limited incomes* of the poor prohibit access to health services, as high costs are the main deterrent to the use of the medical system. Second, *inadequate health facilities* in the districts limit the access. Third, *high drug prices* make the use of anti-malarial drugs, Anti Retro Viral (ARV) drugs for HIV/AIDS,

[2] The national average was 13.7% in 2000.

and other drugs impossible for the large majority of the poor. Fourth, *malnutrition* causes many of the health problems. Fifth, the burden of *large families* constrains the poor in their ability to access health care and prevent diseases. Sixth, lack of important *information and education* limits the use of some very basic curative techniques that would deal with most of the major diseases affecting the people. This includes aspects such as the use of bed nets, reproductive health measures, family planning and other different preventive actions.

Education and literacy

The PRSP recognized that education is connected to poverty in several aspects. First, it is a poverty characteristic itself, but there is also evidence suggesting that completing primary education may increase incomes by about 40% and improve both agricultural productivity and small enterprise development, thus clearly reducing poverty. Second, primary education has beneficial effects on the health situation, as particularly girls' education has an impact on child mortality, morbidity and fertility rates. Although Rwanda traditionally has had a strong primary enrolment compared to other African countries, the household survey estimated the literacy rate to be 47.8% for women and 58.1% for men in 2000. Primary education in 2001 had a gross enrolment rate of 100% and a net enrolment rate of 73.3%, but drop out and repetition rates remained relatively high at 12.8% and 37.6% respectively. The PRSP recognized significant quality and efficiency problems, such as the lack of a relevant curriculum, shortage of textbooks, and low teachers' motivation and competence.

As for secondary education, the first PRSP recognized it as having both direct and indirect poverty benefits. Due to high school fees only 5% of the secondary school children come from the bottom expenditure quintile, but those do directly benefit. Courses include technical education, teacher training and vocational training, and secondary education is regarded as a central motivation for parents' decision to invest in primary schooling for their children. Furthermore, the indirect poverty effects are regarded as two-folded. First, secondary education increases the number of primary school teachers, which is necessary for poverty reduction. Second, secondary education provides the necessary skills required in the labour market and consequently raises productivity. Gross secondary enrolment was 10.2% in 2000, while the net enrolment was 6.0%.

Furthermore, tertiary education is a privilege for a very small minority while the direct beneficiaries are in general not the poor. However, the indirect effects on poverty are regarded as important in the PRSP, as applied research and consultancy in critical areas potentially improve food security, and reduce epidemics and conflict. Furthermore, poverty could indirectly be reduced by better health and education services, increased revenue generation, and employment creation. The use of Information and Communication Technology (ICT) and Geographical Information System (GIS) is also recognized as having similar effects.

Water, sanitation and housing

The PRSP acknowledged the importance of water and sanitation. Its connection to poverty is also regarded as multi-folded, reducing it in several ways. First, it has benefits on maternal and child health. Second, efficiency is improved as drudgery and time spent on collection of water for women is reduced. Third, it is regarded as improving the education enrolment particularly for girls. Fourth, it reduces the cost of health services for both households and the Government, especially for water-related diseases such as diarrhoea. Fifth, productivity is increased due to improved health, thus reducing poverty.

It is estimated that only 10% of the population has access to adequate sanitation. Moreover, although Rwanda has adequate rainfall, many lakes, rivers and high ground water tables, when estimating the actual access to safe water sources was only 44% in the year 2000.

Due to the high density of people, partly due to the approximately 3.5 million people resettled since 1995, housing, infrastructure, and electricity is under pressure. At the time of the first PRSP, about 192,000 people were living under plastic sheeting, and electricity was used by 39% of urban households, whereas among rural household only 1% used electricity. For cooking, 98% of households relied on wood or charcoal, which is mostly collected by women.

4.2 The growth policy of the first PRSP

The discussion of growth is in the background in the first Rwandan PRSP, where the more immediate poverty issues are focused. Still many factors that are important for growth are touched upon. We can distinguish seven factors that can be related to growth:

1. Agriculture and livestock transformation
2. Increased and diversified exports
3. Human development
4. Macroeconomic stability
5. Good governance
6. Effective aid coordination and partnership
7. Private sector development

The first two of those are explicitly mentioned as growth strategy elements, while the others five are indirectly important. We briefly present the arguments for each factor.

1. Agriculture and livestock transformation

Since the overwhelming majority of the population is engaged in the agricultural sector, this sector is important for economic growth. In order for the sector to grow and productivity to increase, transformation is needed and the PRSP focused on two central objectives and certain key factors aimed at fulfilling those. The central objectives were the recapitalization of the rural economy and the participation of poor people both as owners and employees. The key factors that can contribute to the achievement of those objectives include improvements in soil fertility by method of promoting chemical fertilizers and manure, targeted priority crops, improved livestock breeds importation, adaptive agricultural research, extension, and better agricultural infrastructure such as terracing, bunding, water catchments and re forestation. In addition, the PRSP aimed at improving the market strategy for agricultural products by undertaking studies of regional market potentials, supporting a system of market information, close monitoring of price developments and encouragement of farmers' groups to cooperate with marketing.

2. Increased and diversified exports

Exports were recognized as a necessary engine for growth. In addition to the agricultural approach of improved marketing and increased production of priority crops for export, the diversification of exports away from primary commodities was considered important. Six explicit areas were recognized as promising: *Agro-processing* aiming at adding value before exporting, export of *garments*, c*ommercial and ICT services* taking advantage of the regional position as well as the use of both French and English, t*ourism*. *Mining*, and regional *export of skills*.

3. Human development

Like many other first generation PRSPs in Africa, this one had a strong focus on human development through expansion of education health services. In addition to the inherent poverty reduction property, the PRSP aimed to make every Rwandan citizen healthy, educated and housed.

4. Macroeconomic stability

A predictable the economic environment makes it easier for economic agents to make sound plans and investments, and the PRSP targeted low inflation through sound fiscal and monetary policies. This would also encourage savings by reducing returns to cash and avoid competitiveness losses and consequently missed export opportunities due to high inflation. However, even though low inflation is a commitment, there was no explicit inflation target in the PRSP.

5. Good governance

The PRSP recognized the importance of good governance, although it did not explicitly link it to growth. The framework for good governance includes *democratisation*, *decentralisation*, respect of *human rights*, regular P*articipatory Poverty Assessment* (PPA), and the national implementation of *ubudehe mu kurwanya ubukene*. Due to the historical realities, the connection of good governance to conflict and insecurity was also recognized, resulting in programmes aimed at demobilisation, reconciliation, assignment of land tenure and property rights, judicial system improvements, and the *gacaca*. In addition, the importance of separation of powers, transparency and accountability in the government, were also factors recognized as crucial for good governance, and consequently also for economic growth.

6. Effective aid coordination and partnership

In order for sector strategies to be effective, coherent and have a strong impact, the PRSP stressed the importance of ensuring that the Government of Rwanda is in charge of the agenda of public action, where effective aid can therefore cause economic growth. If this is not achieved, the PRSP stated that the increased risk of inefficient and wasteful donor projects in isolation. The method for the realization of effective aid coordination was by the joint Government and donor document "Guidelines for Productive Aid Coordination in Rwanda", which set out proposals for institutional and operational framework in the long run, the PRSP itself, and the use of MTEF to work through the sector strategy processes. The PRSP recognized, however, that the coordination framework is incomplete and a matter for further improvements.

7. Private sector development

The private sector development aimed at the promotion of investment, the reduction of costs and business risk, as well as the stated promotion of exports. The private sector improvements were aimed at both the formal and informal sectors as well as small-scale agriculture, with emphasize on the private sector involvement in policy. More specifically, the PRSP stated the necessary reformation of the financial sector in order for attaining financial soundness and a healthy level of solvency of banks. Bank solvency was to lower the interest rate, along with increased financial market competitiveness and a less risky lending environment. Growth was in turn to be promoted by increasing investment opportunities due to the lower interest rate. A range of reforms were to achieve this goal, among these were the strengthened bank supervision by the National Bank of Rwanda, a review of banks' lending procedures and improved audit functions.

Priority areas

After reviewing the areas of concern for growth and poverty reduction, the PRSP finally identified six broad priority areas for public action. At this stage neither export-led growth nor macroeconomic stability was mentioned, while institutional capacity building and economic infrastructure was added. The final priority list consisted of

1. Rural development and agricultural transformation
2. Human development
3. Economic infrastructure (roads, energy, communications)
4. Good governance
5. Private sector development
6. Institutional capacity building,

The first PRSP targeted a GDP growth of 7–8% per year over the next 15–20 years. However, the World Bank (2004a, p. 10) notes that "the PRSP does not offer an adequate explanation of how the projected GDP per annum growth rates of 7 per cent per year will be sustained." One would like to seem more of an explanation of how the incomes of rural and urban poor will be increased. The World Bank (2004a, p. 11) further notes that the PRSP "does not fully address how financial decentralisation and the technical skills necessary to formulate and implement local development will be carried out. And the PRSP could more fully address how human skill shortages to implement the impressive program goals will be developed."

All in all the first PRSP is a reasonably well articulated document, and many of the strategies and plans set out do make sense in the Rwandan context. Still, there are concerns with regard to the ability of the government to implement policies. There is also concern that the monitoring and evaluation functions are too weak to be able to sustain future reorientation of policies once experiences have been gathered.

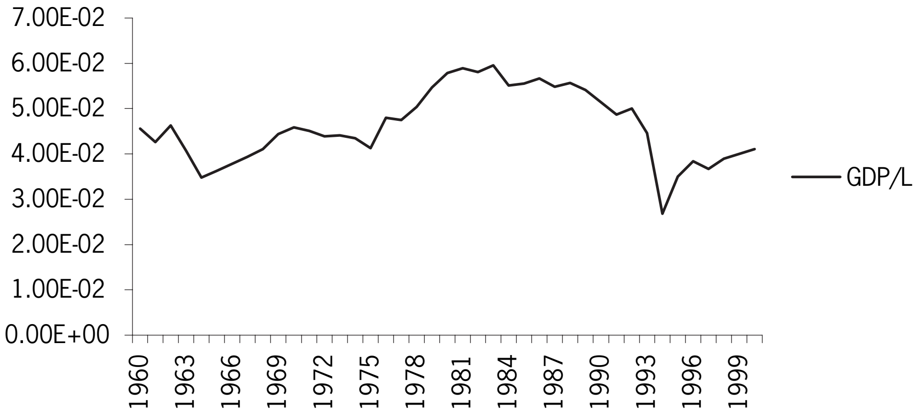
5. Economic Performance

Since the focus in this report is on long-term growth issues, we will start our discussion of Rwanda's economic performance with some more facts about the country's long-term pattern of development. Then we will provide a brief discussion about development during the last few years.

5.1 Growth decomposition 1960–2000

Using data complied by Bosworth and Collins (2003) we can make a crude estimate of the development of labour productivity (GDP per worker) in Rwanda since 1960 (Figure 5.1). The trend was positive until the early 1980s, but then it was reversed and the decline culminated with the collapse during the genocide. Since then there has been a recovery, but this is mainly due to the "peace premium" and does not tell us anything about the long term trends. This rebound effect is petering out, and the historical record does not suggest that Rwanda has been on a trend towards higher productivity. Still, the ambition of the government is of course to create an environment that can generate sustained productivity improvements.

Figure 5.1: Labour productivity 1960–2000.



Source: Own computation using data from Bosworth and Collins (2003)

To pursue this issue a bit further we use a growth accounting framework to decompose the growth in real GDP per worker into the contributions of physical and human capital accumulation per worker and a "productivity growth" residual. This approach has been applied internationally by Collins and Bosworth (1996) and to a set of African countries by O'Connell (2004). He did not include Rwanda in his study, though. We use the data from Collins and Bosworth, who have constructer time series for GDP and the capital stock measured in constant local currency. Like them we assume the same Cobb-Douglas production function, where effective labour input given by *hL*, where *h* is a measure of education per worker and *L* is the labour force. The capital share is assumed to be 0.35. The capital stock is estimated from starting values in 1960 using the perpetual inventory method with a depreciation rate of 5 percent.

By dividing through by labour, we can write the production function as

(5.1.) $$ypw_t = A_t \cdot kpw_t^{.35} hpw_t^{.65}$$

where ypw_t is real GDP per worker, kpw_t physical capital per worker and hpw_t human capital per worker, all in year t. A_t is assumed to measure the level of total factor productivity (TFP). Our estimate of the growth of TFP is calculated from (5.1) as a residual, using

(5.2) $$\Delta \log ypw_t - 0.35\Delta \log kpw_{t-1} - 0.65\Delta \log hpw_{t-1} = \Delta \log A_t.$$

Our decomposition formula thus can be written as

(5.3) $$\Delta \log ypw_t = 0.35\Delta \log kpw_t + 0.65\Delta \log hpw_t + \Delta \log A_t.$$

We thus divide up the growth in GDP per capita (on the left hand side) into the three components on the right hand side. They measure in turn the contributions of physical capital, human capital and TFP (which is a residual capturing everything that is not captured by the two first items).

Table 5.1 shows how the contributions of these three factors have varied over the years. We see clearly in the data for the mid-1990s that the genocide is here reflected as an enormous drop in TFP, followed by a large recovery in TFP. This is, of course, not technological changes but reflects the impact of disruptions of production and changes in capacity utilizations. We see that already by 2000 the contribution of TFP growth has fallen to a more modest level. This suggests that in the longer term growth will require rapid expansion of both physical and human capital, but there should be a contribution of TFP as well reflecting technological progress. How large the latter contribution will be cannot be determined on the basis of the information used here, but historically it has been rather modest and during the period leading up to the genocide the productivity effect was actually negative. This may have contributed to the building up of tensions.

5.2 Recent macroeconomic developments

The macroeconomic targets for 2004 based on the PRSP were (IMF, 2004a) an annual GDP growth rate of 6%, end-2004 inflation of no more than 5%, and international reserves at least equivalent to 6 months of imports. Growth has been decidedly uneven in the last few years. After a record growth rate of 9.4% in 2002 due to very good rains and an exceptional harvest of subsistence crops, there was a serious set-back in 2003 due to drought, which affected agriculture very seriously (Table 5.2). Growth fell to 0.9%, which meant that per capita incomes declined by about one per cent that year. For 2004 the figures are as yet preliminary. The IMF projection 6.0% is used in the table, but the recent

Table 5.1:. Contributions of physical capital, human capital and residual to growth in GDP per labour 1961–2000

	GDP per labour growth rate	Growth rate of Capital/labour	Growth rate of human capital/labour	Contribution of residual
1961	-6.77	-0.35	1.69	-8.11
1962	8.32	0.04	1.59	6.68
1963	-12.79	0.17	1.68	-14.65
1964	-15.81	-0.17	1.52	-17.15
1965	4.22	-0.03	1.53	2.72
1966	4.17	0.26	1.96	1.96
1967	4.08	-0.03	1.87	2.25
1968	4.16	-0.14	-26.13	30.43
1969	7.81	-0.12	29.59	-21.66
1970	3.18	-0.16	2.11	1.23
1971	-1.67	0.25	3.94	-5.86
1972	-2.64	1.11	3.72	-7.47
1973	0.48	1.49	3.51	-4.52
1974	-1.51	1.47	3.33	-6.32
1975	-5.08	2.08	3.17	-10.33
1976	14.92	2.34	2.17	10.40
1977	-0.94	1.99	2.52	-5.45
1978	5.83	1.63	2.03	2.18
1979	8.26	1.70	1.96	4.60
1980	5.64	1.46	1.91	2.27
1981	1.85	1.18	0.75	-0.08
1982	-1.50	2.18	1.10	-4.79
1983	2.52	2.77	1.09	-1.33
1984	-7.72	3.05	0.71	-11.48
1985	0.74	2.84	1.06	-3.16
1986	1.97	2.42	1.72	-2.16
1987	-3.20	2.08	1.68	-6.96
1988	1.44	1.67	1.64	-1.87
1989	-2.82	1.17	1.28	-5.27
1990	-4.99	0.68	1.57	-7.23
1991	-5.58	0.15	1.53	-7.25
1992	2.70	0.09	1.49	1.12
1993	-11.41	0.12	1.46	-12.98
1994	-50.88	6.61	1.71	-59.19
1995	26.63	-1.56	1.39	26.80
1996	9.18	-1.92	1.09	10.00
1997	-4.48	-5.34	1.07	-0.21
1998	5.93	-0.02	1.06	4.89
1999	2.73	0.07	1.04	1.62
2000	2.59	-0.21	1.02	1.78

Source: Data from Bosworth and Collins (2003)

Table 5.2: Rwanda macroeconomic indicators

	1995	1996	1997	1998	1999	2000	2001	2002	2003	*2004 prog.*
GDP, growth (%)	35.2	12.7	13.8	8.9	7.6	6.0	6.7	9.4	0.9	*6.0*
Inflation (%)	48.2	13.4	11.7	6.8	-2.4	3.9	3.4	2.0	7.4	*6.9*
Money (M2) growth (%)	73.7	8.2	47.5	4.8	6.8	14.5	9.2	11.4	15.2	*11.0*
Gross Investments (% of GDP)	13.4	14.4	13.8	14.8	17.2	17.5	18.4	16.9	18.4	*21.3*
Of which: Private Investment (% of GDP)	5.3	5.1	5.5	8.0	10.9	11.6	11.8	12.0	12.8	*12.6*
National Savings (% of GDP)	-5.7	-4.9	-3.7	-2.2	0.5	1.2	2.5	0.3	-0.8	*-0.1*
Of which: Private Nat. Savings (% of GDP)	-0.1	-1.0	-2.7	-0.8	3.9	4.2	5.4	4.5	4.1	*6.1*
Total Government Revenue (% of GDP)	6.8	9.3	10.4	10.6	9.9	9.7	11.4	12.2	13.5	*13.5*
Total Government Expenditure (% of GDP)	20.5	22.5	19.6	18.9	19.6	18.7	21.0	21.3	24.1	*28.3*
Overall Balance Before Grants (% of GDP)	-13.7	-13.2	-9.2	-8.3	-9.7	-8.9	-9.5	-9.1	-10.5	*-14.8*
Overall Balance After Grants (% of GDP)	-2.4	-5.8	-2.5	-3.0	-4.0	0.7	-1.3	-1.9	-2.5	*-2.2*

Note: Private investments and savings include public enterprises.

Sources: IMF (2003a), IMF (2004d)

government estimate (Rwanda, 2004e) put it as 5.1%. Still, there was a return to good growth again.

National savings were still close to zero in 2004, which means that essentially the whole of the investment was foreign financed. On the positive side we may note that private net savings was up at 6.1%, but this of course means that the public sector had negative savings to approximately the same extent. Still that the private sector increases its savings is important and may indicate that financial intermediation is improving.

In 2004 government revenues did not increase any more relative to GDP as it had done over the pervious years. This may indicate that the first and easiest stage of revenue increase is passed. To continue to increase revenues as a share of GDP, which is important of the growth process in the longer term to become self-sustaining, further efforts are needed. Those efforts should be continued efforts to spread the coverage of VAT and other taxes, rather than to introduce new ones or increase the rates charged.

Government expenditures, however, increased by 4.2 percent of GDP in 2004, which increased the public sector deficit excluding foreign aid to 14% of GDP. This increase was more than covered by increased aid inflows into the budget. The overall deficit including aid thus even dropped slightly to 2.2% of GDP. The IMF has previously been concerned about the magnitude of the deficit before aid, since an increase in that indicates that the country is getting further away from a situation where it can be considered self-reliant and there has also been a concern that too large levels of expenditures may run into absorptive capacity problems (See discussion of these issues in Bigsten, Lundström, 2004). Still, aid is given to the government to make it possible for it to spend more than it is able to collect itself. It seems as if the IMF at present is less concerned about this problem in the case of Rwanda.

During 2003 Rwanda missed several observance and performance criteria such as the domestic fiscal balance, the net accumulation of domestic arrears, the contracting of non-concessional external loans, and the net foreign assets of the central bank, reserve money, net banking system to government, the domestic fiscal balance, the net accumulation of domestic arrears, plus some structural performance criteria. The government managed to obtain waivers for these missed criteria, since the breaches were not considered to be too serious and some targets were reached with a moderate delay. There were also reasons that the IMF felt were acceptable such as poor whether as well as the need to smoothen the way for the elections. It was also pleased by the development of economic institutions and financial management as well as the achievements with regard to the poverty programmes. The slippages were also due to extravagant spending on a hotel project and late delayed payments from donors. During 2004, however, the government managed to correct most of these problems.

Government spending exceeded the ceiling agreed by 1.2 percent of GDP, but performance criteria for recurrent priority spending were met and recurrent defence spending was held to 2.7% of GDP. The latter was slightly lower than earlier.

Monetary policy was under stress due to the financing of larger than planned election expenditures and some other interventions by central bank credit. This lead to increasing interest rates and the central bank was not able to sterilize the fiscal impulse and the growth of money supply exceeded the targets. Inflation was as high as 10.2% in December 2004, (Rwanda, 2004c), while the average rate for the year was 12.0%. The monetary expansion combined with the weak export revenues put pressure on the foreign exchange resulting in a substantial depreciation of the Rwandan franc.

5.3 Sector development

The overall sector structure of Rwanda's economy has changed very little (Table 5.3). Agriculture has fluctuated around 45% of total production. However, during the first PRS-year 2002 its share first increased to a peak of 47%, but then it had declined to 43% by 2004. Economic development in poor countries is generally associated with a shrinking agricultural sector, but the recent decline in the agricultural share was mainly due to the serious drought in 2003 and not due to the shift of labour from agriculture to non-agriculture. This process of structural transformation has barely begun in Rwanda.

We know from studies of other countries that have been involved in civil conflicts, that the production decline is concentrated in the transactions intensive part of the economy such as industry and services suffers most, while agriculture, in particular subsistence, agriculture suffer much less (Collier, Hoeffler, 1998). It follows that the sectors that was the largest declines also are the ones that will see the fastest recovery once peace is established.

In Rwanda, however, the industry is only keeping pace with the rest of the economy, but its share of total output is not increasing as one

Table 5.3: Gross domestic product by sector, 1995–2002,% (constant 1995 prices)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
GDP (Rwf million)	336,489	386,560	441,981	482,658	513,89	546,052	580.16	635.60	641.36 (est)	674.30 (proj)
Agriculture	*0.44*	*0.46*	*0.42*	*0.43*	*0.43*	*0.45*	*0.45*	*0.47*	*0.45*	*0.43*
Food crops	0.37	0.38	0.35	0.35	0.36	0.37	0.38	0.40	0.38	0.36
Industry	*0.16*	*0.17*	*0.18*	*0.18*	*0.18*	*0.18*	*0.18*	*0.18*	*0.19*	*0.19*
Mining							0.002	0.002	0.002	0.004
Manufacturing	0.10	0.10	0.11	0.10	0.09	0.08	0.08	0.08	0.08	0.08
Electricity, Gas and Water	0.00	0.00	0.00	0.00	0.00	0.00	0.003	0.003	0.003	0.003
Construction and Public Work	0.05	0.06	0.07	0.07	0.08	0.09	0.09	0.09	0.10	0.11
Services	*0.40*	*0.36*	*0.39*	*0.39*	*0.39*	*0.38*	*0.37*	*0.36*	*0.37*	*0.38*
Wholesale & Retail trade	0.14	0.10	0.10	0.10	0.10	0.09	0.08	0.08	0.08	0.07
Transportation & Communication	0.04	0.04	0.05	0.06	0.07	0.07	0.07	0.07	0.07	0.08
Finance and Banking	0.02	0.02	0.02	0.02	0.03	0.03	0.03	0.03	0.03	0.03
Government Administration	0.07	0.08	0.09	0.08	0.08	0.08	0.08	0.07	0.07	0.08
NGOs							0.01	0.01	0.01	0.01
Other Services	0.11	0.11	0.11	0.11	0.11	0.12	0.11	0.10	0.11	0.11

Source: Rwanda (2002c), Rwanda (2003a), 2001–2002 from Rwanda (2004d, p. 16).

would hope in a process of structural transformation. We have noted that domestic industrial investments are very low and that foreign direct investments are virtually non-existent. It seems clear that Rwanda for the foreseeable future is not going to be a location that attracts investors in manufacturing activities, apart from those that supplies the tiny domestic market or possibly some neighbouring areas such as eastern Congo.

That we see a booming construction sector at the same time as we see little exanimation in manufacturing indicates that building investments relate to government activities and the construction of residential buildings. Improvements in the economic infrastructure are important, though, for the vitality of the economy and much remains to be done before one can say that Rwanda provides a competitive investment climate. Key concerns here are transportation and energy supply. The costs of both these services have been high, and recently there were dramatic further increases in energy prices due to supply problems. By exploiting the country's enormous methane deposits the situation might improve in the future, but investments in this area have just started.

5.4 The external sector

In the section were we identified that main characteristics of Rwanda's economy we noted that the country is one of the most inward-oriented countries in Africa. The share of exports in GDP is only 7.8%. At the same time we may note that the domestic market in Rwanda is very small, and the scope for market production is held back even more by the small extent of monetization of the rural sector. Most production is subsistence oriented. Therefore, to break out of the trap the country is in it is absolutely essential to increase export revenue (although exceedingly generous donor transfers at present largely compensates for the lack of significant export revenue). The key long-term issue is how to shift from donor driven growth to self-sustaining growth. Given the size if the economy, it will not be possible for Rwanda to increase productivity by exploiting scale advantages and by benefiting from specialisation if it cannot increase the share of output going to the export market. Were it not for the donor inflow Rwanda's economy would very likely stagnate and get stuck in the poverty trap we mentioned in the introduction.

The recent export experience is dismal, although there was a considerable upward jump in 2004. Three quarters of Rwanda's export is made up of coffee, tea, and coltan, and some of the improvement in 2004 was due to price increases in these areas. However, coffee export quantity increased by some 75%, which seems impossible. It is argued by the authorities that it is production from plantings 3–4 years ago that is coming on stream, but it still seems unbelievable. Some of the production may be coffee transferred more or less legally from neighbouring countries.

Imports continue to expand independent of export incomes, and it is largely donor related. The deficit on the current account is a staggering 18.7% of GDP.

Table 5.4: Balance of payments

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
International reserves										
(months of imports)	3.3	2.7	4.0	4.6	4.7	5.4	6.0	6.3	5.2	7.1
Exports, f.o.b. ($US millions)	50.4	62.0	93.0	64.1	62.0	89.8	93.4	67.3	63.0	97.9
Of which:										
– Coffee	38.8	43.2	45.3	28.1	26.5	22.5	19.4	14.6	15.0	32.2
– Tea	3.8	9.3	20.6	22.8	17.5	24.3	22.7	22.0	22.5	21.6
Exports f.o.b. (% change)	56.8	22.9	50.0	-31	-3.3	44.7	4.2	-28.1	-6.4	55.4
Imports, f.o.b. ($US millions)	194.1	213.3	277.4	255.7	248.8	239.8	237.9	234.7	244.0	257.9
Imports (% change) f.o.b.	-47.7	9.9	30.1	-7.8	-2.7	3.6	-0.8	-1.8	4.0	5.7
Current acc. (% GDP)										
– without official transfers	-19.1	-19.3	-17.5	-17.0	-16.7	-16.3	-15.9	-16.6	-19.2	-18.7
– with official transfers	-3.1	-6.7	-9.5	-9.6	-7.6	-5.0	-5.9	-6.7	-7.8	-0.7
Real Exchange Rate Change (%)	-39.7	8.6	26.5	-18.2	5.1	-9.7	-3.4	-12	-	-
Terms of Trade Change (%)	22.6	-15.9	40.7	-14.2	16.1	7.7	-21.5	-17.7	4.2	-

Source: IMF (2003a), IMF (2004c), IMF (2004d), BNR (2005), for 2004

The debt stock of Rwanda has increased further in recent years, partly because Rwanda has borrowed money on non-concessional terms in spite of an agreement with donors not to do so. In spite of this it seems as if Rwanda will reach the HIPC completion point during March 2005, and thereby receive a sizeable write-off of debt. This will make the situation easier, although the remaining debts will still be large, at least compared to its meagre exports.

5.5 Government revenues and expenditures

After the genocide Rwanda had very large problems collecting taxes, but tax collection has improved after the establishment of Rwanda Revenue Authority (RRA) and because of a broadening of the tax base. A value added tax was introduced in January 2001. Revenues increased from 11.4% of GDP in 2001 to 13.5% in 2003 and 2004. There are very tight limits to the expansion of tax collections until the GDP level of the country has increased and the rural sector has become monetised. A large part of the revenue growth has been due to increases in the number of taxes and the tax rates. However, a continued growth must increasingly come from growth in the tax base. There is no new tax reforms planned for this year.

Although domestic tax revenues are increasing, a large part of government revenues still come from external grants (see Table 5.5). An increasing share comes in the form of budget support to the government, while another part is made up of project specific capital grants that go into the development budget. Virtually the whole of this budget is donor financed.

Table 5.5: Government revenue by source (% of total revenue)

	1995	1996	1997	1998	1999	2000	2001	2002	2003
Tax Revenue	35.3	51.1	57.3	63.2	72	50	54	55	57.5
Non-tax Revenue	2.2	4.5	3.2	3.2	4.5	2	5	4	3.9
Grants	62.4	44.4	39.5	33	23.5	48	42	41	38.6
Of which:									
Budget support	*19.5*	*1.5*	*2.9*	*3.5*	–	–	*23*	*23*	*26.4*
Capital grants	*42.9*	*42.9*	*36.5*	*29.8*	–	–	*19*	*18*	*12.2*

Source: IMF (2003a), Rwanda (2004b)

The development of government expenditure composition is to a large extent influenced by the PRSP process and the emphasis on priority sectors, which most clearly is reflected in the increase of expenditures on education and health (see Table 5.6). Government services and administration is by far the largest expenditure category. It includes legal institutions, finance and budget, transactions on the public debt, general public services etc. Also the military receives a large budget allocation, although it is declining as a share of the budget and GDP.

Table 5.6: Functional classification of central government recurrent expenditures, 1995–2003 (RwF billion)

	1995	1996	1997	1998	1999	2000	2001	2002	2003
Military	14.8	22.6	23.3	27.2	27.0	25.8	28.6	36.0	24.8
Administrative services	…	18.7	23.8	27.5	31.5	35.7	53.7	57.6	78.6
Economic services	4.1	2.0	1.3	2.5	2.6	2.1	4.9	6.7	8.4
Education	…	6.6	9.8	11.1	17.2	24.0	29.8	17.2	20.2
Health	1.6	1.4	1.5	2.6	3.3	3.8	5.1	4.7	7.4
Other Services	1.5	0.5	0.5	1.0	1.4	2.7	1.3	1.3	13.1
Debt Services	3.8	4.0	3.8	3.4	4.0	1.8	2.8	8.3	10.5
Memorandum items:									
Total Current Expenditure	42.1	55.9	64.0	75.3	87.1	95.9	126.2	131.9	162.8
Capital Expenditure	27.4	39.4	46.1	42.3	40.8	42.0	50.0	40.7	51.1

Source: IMF (2002), IMF (2004c), p.92

Note: The category exceptional expenditures are connected to the special needs to deal with the unique post-conflict situation, such as demobilization, reintegration, and Gacaca.

6. Programme Implementation

6.1 Aid and economic policy

During the last decade there has been a heated debate about the relationship between economic growth and foreign aid. A key paper is Burnside and Dollar (2000), who argued that aid is more effective in good policy countries, while its growth impact was negligible in bad policy environments. Their policy recommendation was that aid should be concentrated to good environments, while Collier and Dollar (2002) argued that aid should be concentrated in high-poverty countries if one wants to have the maximum impact on global poverty reduction. The macroeconomic policy situation in Rwanda at this stage would have to be characterized as reasonably good and the country certainly is poor, so there are good reasons to give aid to the country if the aim is to reduce global poverty.

However, Hansen and Tarp (2001) also showed that there is decreasing returns to aid in terms of its growth impact at least. They explain this by constraints on absorptive capacity, which mean that the positive effect of aid on growth peters out once its size exceeds a certain proportion of GDP. Exactly where this point is in the case of Rwanda is unclear, but given the weak administrative structures of the country it is clear that there are definite limits. The recent Country Assistance Evaluation by the World Bank (2004a) shows clearly that the country is already struggling with the absorption problem with regard to the projects that the Bank supports in Rwanda. A major result of their study is that the projects are too ambitious and complex given the capacity of the Rwanda government in handling them. It is noted, that "projects were uniformly complex and ambitious, including the components for physical investment, as well as for fundamental transformation of the sector institutions and financing mechanisms" (World Bank, 2004a, p. 15). It goes on to say that "implementation of projects was characterized by delays in effectiveness, lack of achievement of major project objectives, multiple extensions of closing dates and cancellations of high proportions of credit funds." It is further noted that "for projects in the urban and energy sectors, complex project design resulted in cancellation (urban and energy) or in substantial underachievement of project goals (energy)". The World Bank found that Rwanda ranks below that of average Sub-Saharan Africa in terms of project performance. The emergency operations and social protection credits received "substantial" ratings, while agriculture, most infrastructure, social sector, and private sector development projects received “negligible” or “modest” ratings. Outcomes of agriculture, all other infrastructure except telecommunications, health and education, and private sector development projects were rated unsatisfactory or highly unsatisfactory. Actually, as much as sixty per cent of disbursements for investment projects were evaluated as having unsatisfactory outcomes. It is furthermore very alarming that “sustainability was rated unlikely for all lending except for telecommunications.” (World Bank, 2004a, p. 12).

The present Rwanda government seems to be committed to the reform process, and the government would by this criterion be a good candidate for aid.[3] Another result coming out of the aid literature which is relevant for Rwanda is due to Collier and Hoeffler (2004). They show that aid can enhance both growth and security post-conflict. Both aid and policy affect the economic variables that determine the risk of civil war. There is thus a second reason for aid to Rwanda, apart from the fact that the policy environment nowadays may be characterized as relatively good.

There are also many studies that show that macroeconomic shocks have negative effects on growth and poverty. Terms of trade shocks are very important in Africa. Booms are not translated into sustain income increases, while negative shocks tend to lead to sustained losses. Aid can increase growth in shock prone countries, particularly if donors are willing to “insure” recipient countries against the shocks. Collier and Dehn (2001) showed that donors are not willing to compensate countries for the effects of price shocks, while they are willing to compensate for natural disasters. One could maybe say that the recent surge in aid to Rwanda is a compensation for the effect of the genocide disaster, but there is no sell-developed system that compensates for example for swings in coffee prices. Such a compensatory mechanism would make macroeconomic policy making somewhat easier also for Rwanda. There seems to be some flexibility in the form of contingency arrangements in the deal with the IMF. It would be useful if such contingencies could be spelled out in a memorandum of understanding, although it is impossible to specify all possible outcomes. There should always be some room for discussions during the period to allow for unexpected shocks.

6.2 Agriculture

Rwanda’s agriculture employs around 90% of the labour force and that it at the same time is highly subsistence oriented. Export crop production is a small share of the output from the agricultural sector. The PRS strategy is to promote some priority crops that are selected because of their high kilo caloric content, the fact that they are well known among the farmers and because they are responsive to increased use of inputs (Table 6.1). A key target of the PRS-policy is to increase output of export crops. Another priority is to increase in the number of animals so that each farm has at least one animal. Since much of the livestock was killed during the genocide, there is very little use of organic fertilizers. Increasing the use of chemical fertilizers is therefore important. Following the liberalisation of the fertilisers market, importation had doubled in 2002 compared to 2001, but in 2003 fertiliser imports and use decreased again. The appreciation of the currency made fertilizers more expensive. There is a range of programmes aimed at soil conservation, e.g. terrac-

[3] Knack (2000) found that there was an adverse effect of aid in so far as during the period 1982–95 it increased corruption and lead to a deterioration of bureaucratic quality and the rule of law. Aid thus seems to be a weak policy to reduce corruption. So while aid has little impact on governance, governance has a large impact on the effectiveness of aid.

ing, reforestation and agro-forestry. The government is discussing the possibilities of encouraging co-operation among farmers to facilitate specialization and commercialisation.

Table 6.1.: Rwanda: Trends in the production of priority crops, tonnes, 1995–2003

	1995	1996	1997	1998	1999	2000	2001	2002	2003
Rice	2,300	6,596	9,805	7,935	8,919	14,503	17,866	20,522	24,425
Maize	55,600	66,595	83,427	58,618	54,912	62,502	80,979	91,686	78,886
Soybeans	900	3,302	6,779	9,831	8.898	13,922	16,336	17,088	19,869
Irish potatoes	137,700	195,381	229,625	181,138	175,889	957,198	1,012,269	1,038,931	1,099,549
Beans	126,300	174,347	133,715	153,917	140,426	215,347	242,157	246,906	239,364
Coffee	21,820	15,230	14,820	14,260	18,333	16,098	18,260	19,426	14,412
Dry Tea	3,956	7,755	12,968	15,129	12,710	13,717	15,166	11,941	12,959
Fruits & vegetables	135,500	189,219	156,221	78,350	82,983	205,675	211,038	233,643	287,620

Source: Rwanda (2004d), p. 39.

Also labour-intensive public works are part of the programme for rural development, which aims to create new income opportunities for the farmers. Activities envisaged concern road construction, environmental protection, water supply, health infrastructure. One stage in the process of income diversification is normally diversification within the rural sector or even within the individual rural households. The government tries to pave the way for such a process of diversification, but so far the impact of the new initiatives has been limited.

The PRS Progress Report for 2004 (Rwanda, 2004d) lists progress made within the agricultural sector in 2003. Much of the progress reported relates to strategy development and preparation of new strategies. There are some concrete measures that have been implemented. For example, 450 technical staff was trained on modern agriculture techniques and demonstration on input use on 550 fields, and fully washed coffee production increased from 28 tons in 2002 to 333 tons in 2003 and the number of washing stations increased from 5 in 2002 to 12 in 2003. The plans for 2004 that are listed consist of further development of action plans, strategies, and policies, plus some concrete actions within mainly the coffee and tea sectors.

Since the agricultural sector is crucial to growth in Rwanda, it is worrying that there has been so little progress in this area. This were the country has its comparative advantages right now and in the foreseeable future, and this is where efforts to make a breakthrough into export markets need to be concentrated. There is an abundance of plans, but again the implementation capacity is lacking. The Ministry of Agriculture seems to be much too weak to do what is already on the agenda. This suggests that ongoing plans to develop even more comprehensive schemes, resembling the old and generally failed Integrated Rural Development Programmes of the 1970s and 1980s, seem ill-advised. What it needed are efforts to build capacity, and the same time as a much more focused work plan is developed. It is better to do a few things well than to do everything badly.

6.3 Private sector development

Growth is important for poverty reduction, and the emergence of an efficient private sector is necessary for sustainable growth to come about. Private sector development is one of the six priority areas of the first PRSP. Here we discuss the extent to which the sector strategy has been implemented.

The strategy set out for the private sector touched upon many issues. The following main objectives for non-agriculture private sector development were specified in the first PRSP:

1 – to encourage investment

2 – to review all legislation in the commercial justice area

3 – to promote the privatization of several enterprises and implement a regulatory structure

4 – to promote manufacturing

5 – to ensure the better management and regulation of mining

6 – to promote tourism

7 – to establish a legal framework and a support network for the artisan sector

8 – to implement an ICT strategy in the services sector

The objectives, which were not ranked, were then disaggregated into actions. Some objectives have several planned actions, some only one, and they show great variance in how well specified they are. We look at how and if each of these were implemented according to the two progress reports written in 2003 and 2004 (hereafter PR03 and PR04).

1. Investment encouragement

For investment promotion three areas of action were paid particular attention. First, Rwanda was to market itself aggressively as a location for investment. Second, a better understanding of the constraints of investors was to be sought. Third, the private sector was to be involved more closely in the design of public policy. In order for these three priorities to be implemented, five corresponding actions were planned:

Action 1: Further strengthening of the 'one stop shop' for investors.
Neither progress report explicitly discuss whether this had been the case or not. However, it is acknowledged as a 'challenge' in PR03 that "the one stop shop is still to be made fully operational", suggesting that the measures had not yet been effective

Action 2: Involve representation from private sector businesses in policy discussions
In this area, progress seems to be have made. The Private Sector Federation, which brings business people and investors together, was strengthened. Within Minicom a department was created to develop public-private partnership, and a "partnership forum" was created to facilitate the participation in policy-making. Although this suggests that the capacity for a constructive dialogue with the government was improved, it is unclear how useful the policy discussions have been.

Action 3: Studies for identification of investment constraints
In 2003, RIPA commissioned a study for investment constraints, and the government held an international investment conference in 2003.

Action 4: Study on areas of potential competitive advantage
No progress is reported in PR03 or PR04, but the work currently going on with the so called Integrated Framework certainly seems to be addressing this issue.

Action 5: Legal reform in order to improve incentives
The major legal reform of the Investment Code from 1998 has been submitted to Parliament, but it is yet to be passed in Parliament at the time of writing (Semuhungu, Kamari, Diawara, 2005).

2. Commercial law reform
Action 1: A commercial court is being set up
No action is reported in the progress reports, but three commercial courts are planned to be established in 2005.

Action 2: A Tax Court and a Small Claims Court are being considered
Neither PR03 nor PR04 report the status of this particular action, declaring neither implementation nor postponement, or what the considerations led to.

Action 3: Government will consult the private sector about the needs for reform
See Action 2 under Investment encouragement, as this is basically analogous.

3. Privatisation
Action 1: Firms will be privatized as rapidly as possible
PR04 reports that as of June 2004, 36 enterprises have been effectively sold to private entrepreneurs, out of the 69 to be privatised. However, according to the IMF 27 of the 77 firms set out for privatisation had been sold by mid-2004 (IMF, 2004b, p. 4). Still, there has been progress in this area.

Action 2: A new regulatory structure to be implemented during 2002–03
The Rwanda regulation agency has become operational, but there is no explicit implementation report on this particular action (PR03, p. 37).

4. Manufacturing
Action 1: The Office Rwandais de Normalisation has been established and will monitor standards
This action has been undertaken, and no other actions were planned for the manufacturing sector in the PRSP.

5. Mining
Action 1: A mining code is being developed that also takes into account the small-scale mining sector
The development of a mining code was reported as an ongoing process, scheduled to be finished in 2002–2003. However, there is not yet a finalized code that has been implemented, and the progress reports do not report whether any progress has been made.

Action 2: The Government will improve the management of the quarries
There is no follow up indicating any improvement of the management of the quarries.

Action 3: The Government will sponsor exploratory studies of Rwanda's mineral potential starting in 2002
There is no report following up on this planned action. However, PR03 reports under 'Progress Made' that more funding is needed, referring to all three actions for the mining sector.

6. Tourism
Action 1: A strategy for the tourism sector is to be prepared during 2002
A strategy was elaborated in 2003, but the implementation of the Tourism Promotion Action plan is not envisaged until 2006.

7. Artisanal
Action 1: The establishment of a legal framework and a national support network will be begun in 2002
A law on artisans' organizational structure, government policy and a 5–year plan has been elaborated. The PR04 does not report whether any progress in terms of implementation has been made.

8. Services
Action 1: The cross-cutting, 20 year ICT strategy will provide environment favourable for the development of skills in this sector
This is an ongoing process. The Cabinet has adopted an ICT strategy, and an Action Plan has been published.

Clearly, the private sector strategy suffers from an implementation problem. Almost half of the planned actions in the PRSP had no reports on progress. There seems to be a pattern of reporting when progress has been made but less so when this is not the case. The evaluation process should clearly follow up planned actions regardless of implementation success.

6.4 Investment

The financial markets fill the important function of channelling savings to investors, but African financial markets are the least developed in the world. What are the specific Rwandan traits that are of interest, and how does the government manage to deal with the policy problems involved.

Macroeconomic constraints on investment

Rwanda is a landlocked country without rich natural resources and its exposure to outside markets is extraordinarily low. The discussion here draws extensively on the different DTIS studies and focuses on cross-cutting issues rather that sector specific constraints. Before looking more closely at the constraints facing businesses on the micro level, it is important to keep in mind that investment opportunities are significantly constrained by macroeconomic factors. When markets are small due to extensive poverty, investment opportunities are also often small. With better export opportunities, investment opportunities increase.

Legal and regulatory framework

In general, Rwanda has a legal framework open to foreign direct investment (FDI). The Investment Code allows FDI above $100 000 to enter freely in all sectors of the economy without any restrictions or exceptions, and provides rights of registered investment with fairly clear restrictions and compensation for expropriation. Compared on a range of incentives for investment (such as investment code, banking laws, taxation, and labour laws) to its main competitors Kenya, Tanzania and Uganda, Rwanda's conditions are competitive.[4] In addition, Rwanda seems to have a relatively low corruption compared to its neighbours.

Still, the Heritage Foundation's Economic Freedom Index for Foreign Investment, gives Rwanda a score of 4 (where 1 is the best and 5 the worst) due to the instability and insecurity, as well as bureaucratic obstacles.[5] Property rights also get a 4. The World Bank Doing Business 'Protecting Investors' gives Rwanda a low score of 1 (where 0 is the worst and 7 is the best), where the SSA average score is 2.1 and the OECD score is 5.6.[6] Clearly, the investors consider the investment climate to be one of the worst in the world.

There are several reasons for this. For example, the commercial laws are inadequate. The commercial code is outdated and incomplete, many remain from colonial times, and its practice is flawed due to lack of clarity, predictability and legal security, thereby imposing severe constraints upon investment, not least FDI. Also, the judicial system lacks not only predictability, but is slow and inefficient. Registering property is a big problem. In Rwanda it takes on average 354 days compared to 48 days in Uganda, which together with costly and time consuming contract enforcement, hinders the establishment of new business.

Access to finance

Access to finance is a major constraint to investment, especially for SMEs. This is to some extent due to inefficiencies in the financial system, but SME investment is also held back by the fact that SMEs lack creditworthiness and management capacity, for example in making business plans and conducting proper accounting. Financial institutions regard (often rightly so) SMEs as insecure and a costly business, partly due to the fact that many loans are small making unit cost high. Financial institutions also lack capacity to evaluate projects and consequently require high collateral, which along with high interest rates causes SMEs to look for finance from other sources. For example, 69 percent of microenterprise financing comes from either own savings or the sale of assets. Only 2.6 percent is financed through loans from financial institutions, NGOs, or employers. SMEs that do organize in associations in a formal way, however, more easily get credit through group financing. It remains unclear to what extent the financing problems of the SMEs are due to problems in the financial sector, and how much is due to the fact that many managers don't even seek finance.

Capacity

The lack of capacity and skills is an important constraint upon investment in Rwanda. Capacity is low, not least due to the genocide. SME managers have in general low levels of education, lack the adequate training and experience to run their business and to plan investments properly. In addition, staff within the SMEs is in a similar way inadequately trained and lack the technical skills. Capacity affects the investment opportunities is several crucial ways, through accessing finance as mentioned, productivity, marketing ability, market information gathering

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[4] This section is based mainly on the comparative study conducted in Semuhungu, Kamari, and Diawara (2005)

[5] http://www.heritage.org

[6] The 'Protecting Investors' variable in measured in a 'Disclosure Index' which captures seven ways of enhancing disclosure: information on family; indirect ownership; beneficial ownership; voting agreements between shareholders; audit committees reporting to the reporting to the board of directors; use of external auditors; and public availability of ownership and financial information to current and potential investors. http://rru.worldbank.org/doingbusiness.

and business strategies to name a few. In sum, the wide-spread lack of know-how put severe constraints upon investment opportunities.

6.5 Exports

Rwanda is an extremely small market, and to expand production and exploit economies of scale firms must be able to export. So what factors prevent Rwandan firms from entering the exports market? How can policy makers help firms entering the international market? And are there any benefits, other than market enlargement, associated with exporting?

The key factors that determine whether a firm will participate in the exports market: are the level of the entry barrier, and the cost efficiency of the potential exporter. It is quite costly for a firm to enter the exports market for the first time. It may be necessary for the exporting firm to set up a marketing department to investigate marketing channels, meet export orders etc. However, if incentives can be created for firms to enter the exports market, they are likely to remain in the exports market for some time. At the same time large entry costs imply that there is a set of firms that remain focused on the domestic market even though they are internationally competitive. By reducing or eliminating the entry costs, these firms will get access to a larger market.

The second factor that determines whether a firm will export is its cost efficiency. It is a well-known fact that exporters tend to be more productive than non-exporters. The question of whether this is because exporting actually *causes* efficiency gains has received a lot of attention in the recent literature. Bigsten et al. (2004) find relatively strong evidence of learning effects in African manufacturing, in the sense that participating in the exports market has positive effects on total factor productivity in subsequent periods. It would appear, then, the Africa has much to gain from orienting its production more towards exporting.

Harding, Söderbom and Teal (2004) find that the strongest explanatory factor of productivity growth over five years among firms in Ghana, Kenya and Tanzania, is the competitive pressure faced by the firms. Firms that face little competitive pressure, and have high profits as a result, record slower subsequent productivity growth than firms that face a lot of competitive pressure. There is also relatively strong evidence that participation in exports markets is a source of improved firm performance. We do not yet fully understand why this is so – it could be that international competition "disciplines" firms to get better organized and become more efficient, or that contacts with firms and customers in developed countries help to speed up the rate of technology transfer. Nevertheless, we know from the data that these positive effects exist. Apart from the productivity effect, international trade leads to concentration of investments in the more efficient sectors according to comparative advantages as well as the exploitation of scale advantages.

As mentioned earlier, Rwanda's exposure to outside markets is extraordinary low, with both exports and FDI at very low levels compared to other countries in the region. In our discussion of Rwanda's export constraints, we look at competitiveness constraints, market access and trade barriers.

Competitiveness constraints

Rwanda has access to international markets mainly through two corridors – the Northern Corridor via Uganda and Kenya to the port of Mombasa, and the Central Corridor via Tanzania. The Northern Corridor is the most used, as roughly 55 percent of Rwanda's imports go through it, while about 40 percent is transported via the Central Corridor (see DTIS studies on transport). By being landlocked, infrastructure has a direct effect on the competitiveness of Rwandan products by influencing transport costs. Table 6.2 show how exports are strongly influenced by the transport costs, sharing 51 percent of the value of exports. Clearly, the landlocked factors imply significant constraints upon Rwanda's export competitiveness.

Table 6.2 Ratio of transport costs to value of exports (2000)

Country	
Kenya	13%
Tanzania	18%
Burundi	31%
Uganda	35%
Rwanda	*51%*

Source: Faye et al. 2004

Furthermore, the competitiveness of Rwandan firms is low not only because of the landlocked factors, but also because of domestic problems such as an inadequate infrastructure. Poor provision of telecommunications, transport, water and power, where energy comes at a very high cost, reduces the scope for investment in modern industry.

Moreover, Rwanda currently has 20–30 regular exporters, but there is a lack of export management skills for delivering products that meet international market demands. Access to markets is contingent on delivering the right products, and most Rwandan firms lack the innovative strength of creating new ideas and delivering new products. Quality control is insufficient as is packaging and market development. The reasons behind this are the low level of capacity due to both lack of technical skills and experience that significantly reduces productivity, as well as lack of information about international standards and market demands. These problems are related to the weak trade supporting capacity of the different government ministries and agencies.

Trade barriers and market access

Although some improvements have been made in recent years in improving custom clearance, business people still complain about significant obstacles when transiting goods through inefficient multiple customs in the Northern Corridor, where delays at the border are long, according to the DTIS studies.

When looking at the overall trade restrictiveness, Rwanda's import regime is not worse than those of with other developing countries. For example, Rwanda scores a 2 in the IMF's restrictiveness index, where 1 is the most liberal and 10 is the most restrictive. Compared to other COMESA countries, which on average score close to 5, this implies that Rwanda is a relatively open economy. When looking more closely, this is mainly due to a liberal non-tariff policy, while the tariff policy is not as positive. Rwanda's ad valorem tariff is on average 18 percent, compared to an average of 15 percent for SSA countries.[7] However, products originating in

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[7] This section draws on Brenton, Ikezuki, and Schuler (2005).

countries that are members of the COMESA free-trade area receive the preferential tariff of zero per cent. Rwanda has no export taxes for any countries, and the VAT rate applied to exports is zero.

The duties levied on some imported raw material inputs, 5 percent, although low, will ultimately affect the competitiveness of Rwandan exports, since most products contain at least some imported raw materials. Moreover, Rwanda has a strong emphasize on ICT as a strategy for growth, but still levies import duties on ICT equipment and products, and although there are some concessions and exemptions that ease these. Lowering the tariffs on raw materials as well as on ICT equipment to zero would be beneficial for exports.

Economic Processing Zones (EPZ) are planned, but have not yet been established, which means that Rwanda is lagging behind other countries in the region. The mostly unsuccessful experiences of EPZs in other African countries, however, suggest that the absence of EPZs in Rwanda may not be significant constraints on its export potential (World Bank, 2001).

So far there has been little progress in export diversification. It seems reasonable to assume that the country has comparative advantages in agriculture. There is certainly scope for increased revenues from this sector. The country is entering into the niche market of high-quality coffee, which already has contributed to increased earnings from coffee. It seems very likely that there is an even greater potential for increased export revenue from horticulture and flowers. These goods have been successfully introduced in neighbouring Uganda, for example, and since they are flown to the European market the location disadvantage of Rwanda hardly applies. There could possibly be some scope for regional export of food crops as suggested in government documents, but since the other countries in the region do produce similar products it is hard to envisage that there will be very large markets to access.

6.6 Human Development

Human development is a many-faceted concept, but we will here focus on education and health. This is probably the area that has seen the best development under the PRS regime and also the area that has been most discussed, so we will be relatively brief here.

Health

The PRSP outlined three main objectives of the health sector:

1. The *prevention* of disease, particularly malaria and HIV/AIDS.
2. To provide increased *access* to basic health care.
3. To ensure improvements in the *quality* of health services.

There were 15 actions corresponding to these objectives. Most actions were planned on the issues of *access* and *prevention*, with only two actions on the *quality* aspect. Looking at how well they were implemented, the results are mixed. First, many of the actions are ongoing processes, stating for example that 'training of health workers will continue' or that 'mosquito nets will be provided', which are important actions, but it is difficult to evaluate the degree of implementation of such goals. In these cases, looking at the health indicators they aim at is perhaps the best guidance for implementation evaluation. However, some straightforward actions have been implemented, and a few have not.

On the issue of access, the introduction of micro-insurance schemes, *mutuelles*, throughout the country is regarded as the main mechanism to expand financial protection against health risks. In 2003, this had reached a coverage rate of 7 percent of the population, increasing from 3 percent the previous year. Also, increasing access by lower drug prices through selective subsidies has been implemented for malaria drugs. However, a clear pricing policy for the most essential drugs has been planned, but not yet implemented. Another focus on the issue of access is the cellule level health *animateurs*, which was planned to have a more central role on guidance of access and preventive measures, as well as the consideration that they expand their services to also include basic curative training and stock of drugs. However, there is no reporting on whether this has been implemented, or to what extent.

Regarding prevention, the main actions were planned and in part successfully implemented. First, the vaccination actions have been implemented in a successful way, and the programme is regarded among the best in Africa with a DPT3 coverage rate of 89 percent. Second, prevention of malaria through the promotion of insecticide treated mosquito nets (ITNs) is regarded as a core strategy, and there were 269,000 ITNs and 391,000 impregnation kits distributed at subsidised prices in 2003, targeting pregnant women and children under five. The proportion of children under five sleeping under an ITN has risen to 18 percent in 2003 according to the PRS PR from 2004, however pointing to the fact that an overwhelming majority of children do not. Third, there have been different actions towards increasing awareness and information about preventable HIV/AIDS actions. This has been according to the progress reports been implemented through *animateurs*, popular radio shows as well as through other media. However, the GoR has made the point that there is a problem with financing other parts of the health sector, as donors in general have a strong focus on the HIV/AIDS issue. The adult HIV prevalence rate at the end of 2003 in Rwanda was 5.1% (between a low estimate of 3.4% and high estimate of 7.6%).

Finally, the health sector seems to suffer from weak coordination, and the PRSP does not outline it any planned coordination action, but the GoR have been working on a Health Sector Strategic Plan (HSSP). This strategy focuses on a sector wide approach, and has been developed through collective workshops and with budget support donors to reinforce collaboration and coordination. According to GoR, the HSSP will be ready to be implemented in 2005.

Education

The first priority for the education sector in the PRSP was the Quality Basic Education for All (EFA). In addition, technical and vocational skills at the secondary and tertiary levels, as well as training of girls and the provision of education in ICT, were outlined as focus areas.

One of the major actions planned, the development of the Education Sector Strategic Plan (ESSP), was finalized aiming at improving *planning*, *coordination* of interventions as well as *decentralisation* of some functions to provinces, districts and schools. The plan is a rolling development plan over 2003–2008 and is to work as the plan making the Education Sector Policy operational and an instrument to guide to all operators of the education sector. As a part of the ESSP, the planning process was rolled out to provinces in 2003 and now all provinces are reported to have at least a draft education strategy. An EFA plan was also finalized in 2003.

In addition, there were actions towards improving priority areas. Regarding Early Childhood Care and Development (ECCD), there were two actions planned, developing an ECCD policy in 2003 and encouraging participation of the private sector and civil society in ECCD. On the implementation side, however, neither an ECCD policy has been established, nor are there any reports on how the private sector and civil society has been encouraged in practice.

In primary education, an important step was the fee free primary education and government capitation grant effective from September 2003, although this for some reason was not an education action outlined in the PRSP. Many of the actions planned for primary education is of the character 'continue teacher training' and 'increase supply of textbooks', and the extent to which this has been implemented is somewhat unclear. Looking at the indicators, qualified teacher/pupil ratio was reduced from 72.7 in 2002 to 70.3 in 2003, and gross primary enrolment figures increased from 99.9% in 2001 to 110.2% in 2003, signalling that improvements are taking place. Although the outlined goal of the PRSP of one textbook in three pupils seems far away, the overall judgement is that most actions planned in primary education was implemented at least to some extent.

In secondary education, the actions focused on increased access and quality, with a special focus on the poor and girls. Of major achievements were 94 newly opened lower secondary schools throughout the country in 2003. There has also been an announcement of 9-year basic education. Of the three planned actions in tertiary education, two of them have been implemented by initiating the Students Financial Agency for Rwanda and the established Higher Education Bill. However, there is no report on how the planned action of increasing research aimed specifically at poverty reduction has been implemented.

6.7 Economic infrastructure

The poor infrastructure in Africa is clearly a severe constraint to manufacturing growth. Collier's and Gunning's (1999) review of studies of growth determinants in Africa indicate that infrastructure matters a lot. Compared to other regions public expenditure as a share of GDP has been higher in Africa, while service provision has been worse. Many firms have to spend own resources directly on buying infrastructure services or providing it on their own. Poor infrastructure constrains firms producing for the whole of the domestic market, but it is also a severe constraint for exporters. In the case of Rwanda producers are located very far from the sea, which increases the need for a good transport network, particularly for industries aiming to supply the world market. Recent studies have also generated a lot of information about how firms perceive infrastructure problems and lately also about time and monetary costs of different bottlenecks. The latter information may relate to days in customs, days without telephone connections, days without electricity etc. To be able to take advantage of international trading opportunities and to engage actively in the emerging system of outsourcing there must be a reliable and cheap infrastructure and a good regulatory environment.

Poor infrastructure and high utility costs hold back competitive production and drive up costs, thus undermining the potential for the output expansion. Excessive regulations result in entrepreneurs forming very small and informal firms rather than formal organizations that have export potential and contribute to tax revenues. The fact that key market institutions – such as laws, courts, business associations, lobbies, quality control, protection of property rights and enforcement of contracts – are underdeveloped means that personal relationships play a central role when firms make their output and input decisions, which hampers market integration.

The policy focus in Rwanda with regard to economic infrastructure is on the maintenance and rehabilitation of the rural road network to promote trade, encouragement of competition in air transport, reduction of the cost of electricity by increasing the domestic production, rural electrification to promote a broader set of economic activities in the rural areas, and the encouragement of competition in the area of telecommunication. Part of the strategy is thus to try to increase efficiency by opening up the market to competition, or at least by letting private companies manage some public companies. Rural road improvements are expected to be achieved with public works programmes.

The Progress Report of 2004 reports ongoing work to rehabilitate and maintain the road network, which clearly is essential. The poor transport network still is a serious constraint on growth in Rwanda and contributes to the exorbitant costs for firms to get goods to the world market. The most promising type of new export activity is probably horticulture, flowers and similar products that can be flown out. Here Rwanda would not have a cost disadvantage relative to the neighbours if it can get the international airport in shape and warehouses built that can cope with the produce. Planning is underway, but so far little investments have actually been undertaken. With regard to privatisation of communications companies such as Rwandatel the progress report notes that the process continues.

The second crucial area is energy supplies. The situation for energy supplies has actually become even more difficult during the last year due to production problems. This has had the effect to raise the oil import bill from US$40 million to US$68 million, and this is a heavy burden on the economy (Banque National Du Rwanda, 2005). Plans to exploit alternative sources of energy such as methane may in the future make a sizeable contribution. It is hoped that production of electricity from this source will be possible in 2006. Privatisation efforts, for example of Electrogaz, have made little progress, and there is not much other private investment in the sector. The energy sector is clearly critical for economic growth, and for the country to take off it seems necessary to undertake major investments in energy. The first option would be to invest domestically, but if production possibilities are poor relative to those in neighbouring countries it may well make more sense to hook up to the regional grip and to import energy. Whether the latter option is preferable depends on the relative costs of the two options and the returns to the potential investments that could be undertaken within Rwanda with the money that is freed up by investing less in domestic energy production.

6.8 Governance

The progress in the reform of the financial system is respectable. Since 2000, the Government has created the Offices of the Ombudsman and the Auditor General, and has established the National Tender Board. Budget preparation takes place within the framework of a Medium Term Expenditure Framework (MTEF), budget monitoring is done within the SIBET system, and budget execution is controlled within the cash budget system and the Treasury Management Committee. Many reforms have been undertaken during the last few years, and there has also been progress in financial management. Still, much remains to be done before there is a smooth system in place.[8]

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[8] IMF (2004a, p. 18) sums the situation up as follows: “The strengthening of public financial management constituted the

The first PRSP was completed in June 2002. The idea with the new process is that the budget shall be embedded in the overall strategy for growth and poverty reduction derived from the PRSP. The present budget process can be described as follows: The starting points for policy making is on the one hand the very long-term strategic plan Vision 2020 and the national plan as set out in the PRSP, which identify needs and lays down priorities. Between January and April each year Minecofin reviews the macroeconomic framework and expenditures and performance of the past period. The ministry now has developed a model that it uses for simulation exercises. A preliminary budget ceiling respecting the limit on the deficit set in the PRGF is set by the Cabinet. Then Minecofin circulates a budget circular with the ceiling to ministries, provinces and government agencies. In April-May Minecofin requests strategic issues papers from the ministries, and once they are in the budget implications are analysed. The focus is on the poverty links, major constraints, actions taken, strategic links, and development partners. Once this work is done a seminar on the next year's budget is organized and there are sectoral consultations at the ministerial level. Minecofin then draws up a list of contingency expenditures, which is sent to the Cabinet for decision. Once this is done the ministry prepares the Budget Framework Paper, and the aggregated macro frame for the next three years goes to the Cabinet for decision. Then the issues raised are dealt with and a final ceiling is produced, which is approved by the Cabinet and submitted to the ministries. The budget then is finalised at the ministerial level, and after that Minecofin coordinates all the inputs and produces the final budget. This is sent to the Cabinet and there are discussions with the IMF and other donors, and then it is sent off to the Parliament that finally decides. Until now the three year plans have so far not been submitted to the parliament, but they will be so in the future according to the new Organic Budget Law. By November (in the future it will be October) the finance law is approved and sent off the Prime Minister's Office for implementation. During the budget year Minecofin prepares cash budget estimates every month. Ministries are not allowed to spend beyond these limits. There is also a special Management committee that follows whether the PRGF conditions are met, and that the government is able to meet the conditions agreed upon.

As this outline shows the MTEF implementation has progressed considerably, and the budget implementation has been computerized and transparency improved. Still, much remains to be done, and even early 2005 donors had not yet received the full report on budget outcomes for 2003.

The main structural problems in the current budget formulation process are the partial integration of the budget and the poor donor integration. At present there is a major project underway at Minecofin aimed at budget integration. So far the development budget has not been properly integrated with the recurrent budget. The aim is to create a programme structure with both recurrent and development included. This is supposed to include the total resource flow, including funds from the donors. Still, the reporting of the latter still leaves a lot to be desired.

Monitoring and evaluation are also key elements in a functioning budget system. What is required for monitoring are indicators, access to relevant data, publication of monitoring information, and use of this for

most ambitious component of the reforms agenda. While the achievement of specific objectives has proven to be a greater challenge than had bee anticipated, overall progress can only be rated as a major success. The adoption of a new constitution at end May 2003 established a new and clear framework for the institutions of public finance. The Auditor General (AG) was vested with sole accounting authority, reporting directly to parliament."

continuous update and development of the PRSP. The financial monitoring is functioning reasonably well, but there are huge problems with regard to physical monitoring. A pilot has been done in social sector, and the results were very poor. Among the explanations for not implementing what was planned administrators for example argue that no budget was made available for the tasks at hand. Sometimes the local authorise choose to shift money from priority sector to existing mainstream activities.

The decentralization of the units of government started in 2000 with the aim of increasing broad-based participation in the design, implementation and monitoring of projects. The Community Development Fund (CDF) was established to oversee and coordinate the administration of the districts and to channel the part of the budget that is earmarked for projects or programmes at the district levels (FARAP, 2003). Some progress has been achieved in this direction, but the target level has not yet been achieved. The district level administration is very weak, and it is not self-evident that one should opt for extreme decentralisation in a situation where one of the main constraints is the lack of trained personnel. There is currently no financial ceiling provided for district planners, so these plans are not properly costed or take the resource constraints into account. They should be integrated with the national MTEF for this to a meaningful exercise. (IMF, 2004b, p. 5).

Apart from the structural problems there is also the whole problem of incentives for those doing the work. In Minecofin some strategic personnel have had their salaries topped up by donor money, but once this ceases salaries may fall by 60–80%. There is then an obvious risk that the trained people will leave for the private sector. In the MTEF implementation efforts many government officials in the ministries and public corporations have been trained, but the retention rate of those is in some instances less than 20%.

The major governance problem is about how to make the bureaucracy work more efficiently, and this is a time consuming process. Documents and strategies can be produced relatively easily, but to get the administrative apparatus to implement the policies in a consistent and efficient manner is much harder. This is in a way the key challenge of the government. [9]

Rwanda has a relatively good track record in terms of the reorientation of overall policy. There has been a clear shift of resources towards priority sectors, but with regard to the much harder challenge which is to reform administrative structure progress has been smaller. This is the core problems of development policy in Africa today. The governments do not need new initiatives, but they need to reform the regular structures so that they can accommodate the ongoing programmes. Too many evaluations end up with recommendations for new structures, but the main thing we think is to make a simple structure work well, and that requires training and incentives. To give very weak administrative structure new tasks without eliminating old ones can be counterproductive.

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[9] See discussion on Malawi in Durevall and Erlandsson (2005).

7. Poverty Outcome

The major outcome variable for the poverty reduction strategy is of course the poverty variable. To measure poverty change properly over the last few years we would need a new household survey to compare with the one done in 2000/2001. Unfortunately, the next survey will not start until August 2005, so no solid information will be available until well into 2006. Will anyway attempt to say something about the likely range of poverty outcomes for 2004 and compare this with the 2000 figures.

The World Bank (2004a) summarises what is available about distributional changes between 1985 and 2000 (Table 7.1). The detailed picture for 2000 is shown in Table 7.2.[10] We compute Gini-coefficients on the basis of the information in the table. Comparing the estimates we clearly see that there was a dramatic increase in inequality over the period 1985–2000, with the share of the bottom 20% seemingly going down from 9.7% to 5.4%. The huge drop between 1985 and 1990 seem suspiciously large, but this is not a main issue here. Our main concern is to be able to say something about the change since 2000.

Table 7.1: Income distribution – Percentage shares of GDP per quintiles of population

	Lowest 20%	2nd 20%	3rd 20%	4th 20%	5th 20%	Implied Gini-coefficient
1985	9.7	13.2	16.5	21.6	39.1	29.0
1990	7.6	11.3	15.1	20.9	45.3	37.1
1995	6.5	10.4	14.3	20.6	48.3	41.2
2000	5.4	9.4	13.6	20.2	51.4	45.4

Note: The Gini-coefficients here are estimated from the information about five point in the table only, and we therefore get estimates that are lower than the correct ones.

Source: World Bank (2004a), p. 4.

10 A presentation of a range of different poverty results is available in Rwanda (2002a).

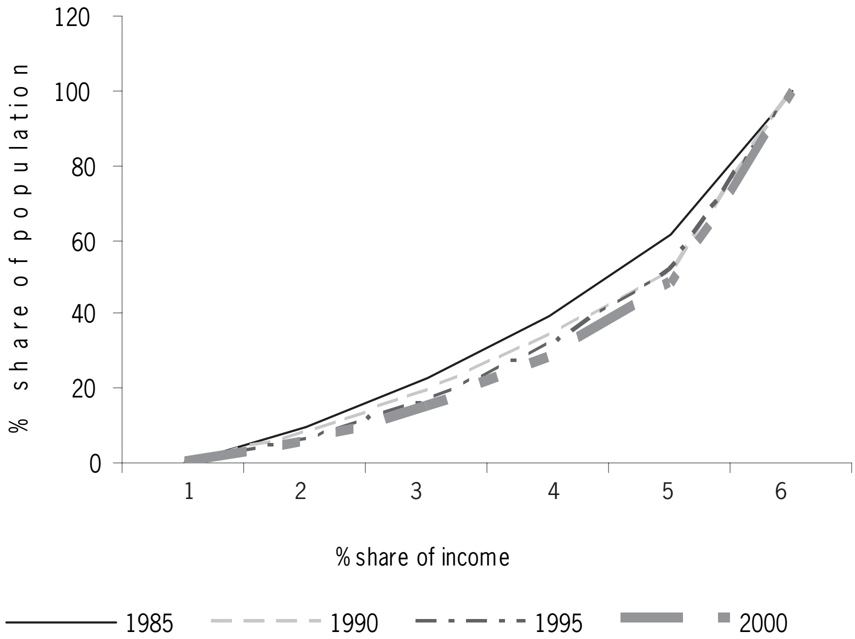
Table 7.2: Mean expenditure per adult equivalent by expenditure quintile

Quintiles	Level of expenditure in RwF	Mean annual expenditure per adult equivalent
1st quintile	<29.716	21.196
2nd quintile	29.716–43.870	36.544
3rd quintile	43.871–63.582	53.211
4th quintile	63.583–98.515	78.633
5th quintile	More than 98.515	200.462

Source: Rwanda (2002d), p. 18.

Using the data in Table 7.1 we draw Lorenz-curves for the four years. Since the Lorenz-curve is moving outwards throughout the period and the curves do not cross, we can definitely say that inequality has increased (if the data are correct).

Figure 7.1: Lorenz curve for Rwanda 1985–2000



Since we want to provide an estimate of poverty in 2004 to compare with that of 2000 at the same time as the relevant data are not yet available, we need to make some assumptions about what has happened to the income distribution between 2000 and 2004. We make two alternative assumptions about the income distribution in 2004. For hypothetical distribution A we assume that the distribution has remained the same as in 2000. Given the very limited structural change during the period this is not an unrealistic guess. For hypothetical distribution B we assume that inequality continued to increase in the same fashion as it did during the period 1995–2000. The change 1995 to 2000 was due to a process of return to normalcy that normally benefits the better off more than those at the bottom of the distribution, for example subsistence producers, and this suggests that it is unlikely that the trend continued unabated between 2000 and 2004. We would at least argue that it is unlikely that inequality increased more than this. So this can be seen as a maximum estimate of inequality and thus also a maximum estimate of the extent of poverty in 2004.

Table 7.3: Income distribution – Hypothetical percentage shares of GDP per quintile of population in 2004

	Lowest 20%	2nd 20%	3rd 20%	4th 20%	5th 20%
A: 2004 (same as 2000)	5.4	9.4	13.6	20.2	51.4
B: 2004 (same change as 1995–2000)	4.67	8.59	13.02	19.86	53.86

Note: Hypothetical distribution A is the same as the one in 2000. Distribution B is derived on the assumption that the pattern and rate of change between 1995 and 2000 continues between 2000 and 2004.

On the assumption that population growth was 2.2% per year between 2000 and 2004 (as assumed by IMF, 2004d, p. 54), we had an increase in per capita GDP over these four years by 13.8%. We thus scale up the average income level of 2000 by 13.8%, apply our two hypothetical distributions, and then compute poverty measures for 2004 for distribution A and distribution B using the poverty line of 64.000 RwF.

We then see that even in the unlikely case that inequality continues to increase as rapidly as between 1995 and 2000, poverty as measured by the headcount index actually declined significantly. Thus, in spite of one poor year 2003, when poverty certainly increased temporarily, we find that over the period the strategy was successful in reducing poverty. Our estimate is that the headcount index declined from 60.2 to the range 53.5–55.6. This is still a very high poverty level even for Africa, but it is an improvement. When we look at the P1 (poverty gap) and P2 (severity of poverty) measures, we see that for our simulated case with increasing inequality these show considerably less of an improvement relative to 2000. Since these measures take into account what is happening also within the group of the poor, they are more negatively affected by the inequality increase than the simple headcount ratio. In any case, it seems quite safe to say that there was a respectable poverty reduction between 2000 and 2004, and for an African context it is very gratifying. If the ambitious growth target had been reached the improvement would of course have been even larger.

Table 7.4: Poverty in Rwanda: 2000–2004

Year	P0	P1	P2	Gini
2000	60.2	25.3	13.6	45.4
2004a	53.5	21.3	10.9	45.4
2004b	55.8	24.0	13.2	48.0

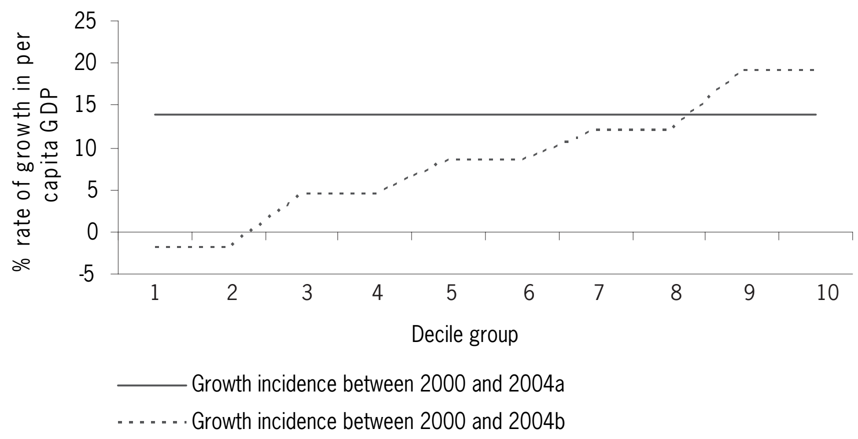
Note:

a) Per capita income grows at 13.8% and Gini remains at its 2000 level

b) Per capita income growth at 13.8%, and Gini follows the change that prevailed between 1995 and 2000.

An effective way of illustrating the results of growth over a period of time on the income in different segments of the income distribution is to draw a growth incidence curve. We have drawn two such curves for our two hypothetical scenarios for 2000–2004. Case A, which is no distribution change, is of course a straight line indicating that the incomes in all deciles increase by the same 13.8%. Case B, which is the inequality increasing simulation, yields increases which are at their highest at the top and then falls down to even a negative change for the bottom 20%. Here 40% of the population that was poor originally experience improvements in their absolute level of income, although not as much as the non-poor. So if this curve is the relevant one growth was not pro-poor according to the strict definition, but the extent of poverty declined. So even in case B the growth process was reducing the extent of poverty in Rwanda.

Figure 7.2: Growth incidence curve for Rwanda 2000–2004



Our crude estimate of poverty change thus indicates that poverty declined between 2000 and 2004 from a headcount index of 60.2 to somewhere in the range 53.5–55.8.

8. The Future of the Poverty Reduction Strategy

8.1 The PRS-process

The IFIs have evaluated the implementation of the PRGFs in several countries (IMF-IEO, 2004, World Bank, 2004b). Four main results have emerged: (1) A key result is that the emphasis in the future should be more on establishing a good process rather than to produce good documents. That is, implementation is the key at this stage.[11]. (2) It is also noted that feedbacks are still very week, which is unfortunate since this input is needed for the improvement of forward budgeting. (3) It is also clear that the underlying analysis is weak in many instances and needs to be strengthened. (4) The partnership is weak in some areas, particularly in relation to prioritization and costing of interventions.

The conclusions that one can draw for the case of Rwanda are consistent with those drawn for several other countries. Our major conclusion is that there is a serious lack of implementation capacity in the Rwandan government as soon as we get below the absolute top level. This makes a second conclusion rather obvious, namely that there is reform overload. Third, the PRSP falls short of proving a road-map for macroeconomic policy making and structural growth oriented reforms. Fourth, there is limited feedback from implementation to policy making reforms.

The PRS process is sensible, that is that budgeting is done from desired ends. But the demands on the system are high and to make the process more realistic much more training is needed further down in the hierarchy of planners. Moreover, there is also a serious concern about incentives. Even if people know what to do, they may choose not to do so because the incentives are too weak. This could be an issue of salaries or that administrators can benefit from the existing system in various ways that makes them reluctant to change it. Administrative reforms are underway, but this will be a very drawn out process.

The main thing is to get the process right. It is fine for the production of reports, but it is weak when it comes to implementation. There is not as yet an efficient system of monitoring and evaluation. Financial monitoring, which is better developed, is required by donors if they are to accept to give "free money". The physical tracking is needed by the central planners as an input into the policy making and budgeting activities. The Poverty Observa-

[11] A key recommendation from the IMF-IEO (2004) evaluation is to "shift the emphasis of the initiative from the production of documents to the development of sound domestic policy formulation and implementation processes."

toire, which coordinates the PRSP work, has worked with various departments to set up an elaborate system of monitoring and evaluation. At the district level there is a system of reporting on a few indicators that are to be comparable across districts, plus other variables that are important to the district in question. District personnel have been trained and manuals have been developed. So far, implementation has not progressed that much.

In the PRS process there are many process requirements, but the requirements for the design of the product are less clear-cut. The PRSP of Rwanda, like many others, rested on a rather weak analytical base. The macroeconomic framework was not well developed when the PRSP was formulated, but some progress has been made with regard to the macro framework since 2002. The required micro-macro analytical links are still weak though, although the PSIA done in Rwanda did a very good job given available information (Mackinnon et al, 2003). The first PRSP was largely expenditure focused, while it would be desirable for the new one to shift towards more serious analysis of supply issues. The two progress reports that have been done so far are relatively short on outcome data, but this should be better after the new household survey is completed.

The aim of the new PRGF facility was to give the government more policy space, and this has been realized in the case of Rwanda. There has been increased flexibility in the stance of the IMF in Rwanda. Fiscal targets have been interpreted more flexibly and the IMF has overlooked macroeconomic breaches of targets and defended it with good performance on social priority expenditures. There was to be a reduction in the extent of conditionality within the programme, but the reduction has been very limited. Conditions are largely there in the same way as before. It must be noted, however, that the reduction of conditions in reality is going to be intimately related to how fast the government is able to put adequate reporting systems in place. There is progress, as we have noted, but the system has shortcomings. On the whole policy making is based on the PRS system demanded by the donors, and much of the world is oriented towards satisfying the demand of those. The process as it is largely driven by the IFIs. In that respect the situation has not changed much since before the PRS period.

IMF still does fulfil an important signalling role. If the IMF says that the process is on track, the other donors will release money to the government, primarily budget support resources. IMF's comparative advantage would be its macroeconomic competence and that should be its focus, but in the case of Rwanda it seems that there has been some shift in the direction towards a sectoral focus. Compared to the old ESAFs it seems as if the PRGFs allow greater fiscal flexibility and it supports increases in social spending. A problem with the PRGF is that the conditionality that is in it does not derive directly from the PRSP. Alignment could thus be better.

Country-ownership has anyway increased and the government seems rather confident about its policy-making ability. The key problem lies in the implementation of the policies decided, and that is a problem that is clearly country-owned. It is also a problem that needs a country-solution, but this is something that will not be done within a short span of time. This is the greatest challenge to the government in Rwanda, like for most other countries in Sub-Saharan Africa.

8.2 Implementation of growth policies in the PRS

Rwanda is a landlocked country, where growth opportunities are comparatively poor. However, this doesn't necessarily imply that policies in Rwanda aimed at growth are useless. On the contrary, since the potential is lower than in countries with a better location, growth may be more contingent on good policies than in countries with better opportunities. Policies that are "good" for long-term growth, might be the ones that best aims at getting around the "landlocked"-factor.

Rwanda may also be characterized as a polarized society, and the genocide is a sad proof of this fact. This puts extra high demands on policy makers. It is often a concern that policy makers are more interested in redistribution issues than growth issues. Some types of redistribution measures may be considered essential for the ruling group to stay in power. Sometimes there may also be a situation where even redistribution measures negative for growth may be necessary to stabilise an unstable situation or to buy peace. The outcome of seemingly inoptimal transfers may be better than that of a counterfactual with civil war. The situation in Rwanda seems to be a case where the need for stability and peace will have to be high on the agenda for policy makers.

So what has been achieved with regard to the growth strategies that we identified in section 4.2?

1. Agriculture and livestock transformation

There has been some progress with regard to the upgrading of the coffee for the niche market, and a dramatic increase in 2004 if we believe this official numbers (which we don't). Otherwise the development of priority crop production has been disappointing, and there has as yet not happened much in terms of the most promising exports, which are horticulture, flowers and the like. The implementation capacity of the Ministry of Agriculture is weak, and the evaluation of the agricultural programme done by the World Bank is very critical.

Sound property rights institutions are clearly very important for growth also in agriculture. The World Bank (2004a, p.7) notes for example that "without a land tenure reform or some other institutional arrangement that clearly defines property rights, farmers may not be willing to make investments necessary to increase agricultural productivity."

2. Increased and diversified exports

Again there has been some progress in coffee, but otherwise nothing of substance has yet materialised. The government is still at the stage of producing strategies and plans, the implementation of which has not progressed very far. There are no clear results to point to as yet.

3. Human development

This is the main area of success. School enrolment in primary schools has increased dramatically with the introduction of free primary education. Access to health facilities has improved, but at the same time there is a negative trend with regard to life expectancy (probably due to an increasing aids impact).

4. Macroeconomic stability

Rwanda has over the last few years been close to or over the margin of what the IMF considers acceptable, but in spite of quite a few reaches of conditionalities there has not as yet been any long-term break with the IMF and thus the donor community. It is not clear that the imperfections in the implementation of macroeconomic policy have been so serious that they have been a significant obstacle to growth. There has not been any obvious risk of serious macroeconomic instability

5. Good governance
Governance has been good in the meaning that corruption within the government is less than in comparable countries in the region (as far as one can tell from anecdotal evidence). Governance is poor in the meaning that the implementation of the ambitious programme of the government is very weak, to some extent due to poor structures but mainly due to lack of capacity and possibly also incentives to implement policies. The government faces a dilemma: On the one had it wants to put new structures in place as soon as possible, but at the same time there is not enough to capacity to run the core structures that are already there. This is a case of reform overload and there should probably be some sort of moratorium on new reforms.

6. Effective aid coordination and partnership
There has been some progress and the shift among several donors towards budget support is good and makes the task easier. In accordance with the arguments under 5, the donors should not try to impose too many conditions on the government and thereby contribute to a further overloading of an already overworked administrative system. The competence level in the administration declines rapidly as one move down the ladder. Rwanda may be one of the environments where donors would be willing to push in quite large aid resources due to the relative honesty in the system, but it would probably still be hard for the government to efficiently handle programmes that require much human implementation capacity.

7. Private sector development
This one we would have to call a failure. So far there is hardly any non-agricultural activity that is expanding, and exports outside agriculture and natural resources are negligible. During the last decade there has been a mass of studies of African manufacturing (Bigsten and Söderbom, 2005). They show that markets generally are small, the economic risk is high, credit is either expensive or not available, skilled labour is expensive, and the infrastructure is poor. The situation in Rwanda in these respects is clearly even worse than that of most other African countries. The obstacles to industrial development here are thus tremendous and it does not seem as if the government has managed to improve the business environment very much over the last few years. Electricity supply is more unreliable than ever and prices have doubled. The transport situation remains bad, and since this is a key constraint for Rwanda this is very serious. There should be an attempt to develop capacity to export horticultures. Rwanda will not be able to integrate with the rest of the world economy unless transport links are developed. Here there clearly is a need for large infrastructure investment, and some of those probably could be done with foreign funding without running into a serious absorption problem. To build roads and railways is fairly straightforward and it could have a considerable direct foreign resource input.

8.3 Evaluating the PRS and designing PRSP2

The monitoring of outcomes is still not so well developed, but there is some data that could tell at least a partial picture. A core welfare indicator questionnaire (CWIQ) household survey was carried out in 2001 and 2003 and an extended version of this is to be implemented in 2005. This has not been extensively analysed yet, although some indicators have been computed. Public Expenditure tracking surveys were undertaken in

1999 and 2004, and also here some information can be obtained. In some important areas thee is very little data. These concerns for example labour market issues were survey work may begin within a few years. Data about small and medium enterprises are also scarce.

There are some shortcomings of the evaluations done so far of the implementation of the PRS in Rwanda. The first is that there is a dearth of outcome data in several areas, since the reporting system has not been developed to the extent hoped for. One aspect of the PRS that needs to be developed is thus the structure and functioning of the data reporting and feedback system. In that context one should also look into the capacity of the recipient institutions to utilize the data collected, since there is no use to collect data that are left unanalysed. The Poverty Observatoire has clearly not been able to utilize what has come in for effective analyses, and some new arrangement may be called for. It seems reasonable that the newly created statistical unit gets an increased responsibility for the data collection and analysis, since this is where the best competence is or should be. Then one should make use of the best analytical skills available..

The evaluation of the PRS-period should attempt to evaluate how well the processes of policy implementation work. It would be useful if there could be analyses of the actual working of the administrative institutions and how they relate all the way down to the local level. Also the existing system that is supposed to monitor and evaluate should be analysed.

Much of the analysis that went into PRSP1 is still relevant. Not that much has happened since 2002, and the structural problems that existed then remain. There is thus reason to argue for a radical departure from the strategic thinking that went into the report. What is primarily needed is a much more serious attack on the implementation issues, and a more realistic approach to what the system can cope with.

In terms of contents we do agree with many other observers of the Rwandan economy that growth and trade issues need to be given a higher profile. IMF (2004a, pt. 22) argues that "the immediate challenge will be the full elaboration of policy frameworks in the non-social services and their implementation. In particular, in the period ahead, an increased focus will be placed on improving the supply response of the economy, reducing its vulnerability to exogenous shocks, and strengthening the performance of the external sector." These areas should obviously be key components of the strategy for the future

So far, there have been few actions planned within the private sector to increase exports. In the overall strategy, the PRSP recognizes that increasing and diversifying exports away from primary commodities are important for economic growth and that particularly six areas are promising. There were some actions planned relating to mining, ICT, tourism, and manufacturing, but the implementation of these actions was incomplete. This is an area that needs to be better focused in the next PRSP.

The principle of concentration discussed above applies also to the design of policies. As an example we can consider one of the productive sectors that need to be developed if Rwanda is to achieve a sustainable growth process, namely manufacturing. From what we have already discussed it should be clear that the manufacturing sector must break into the international market if it is to see significantly increased levels of productivity. This requires the adoption of new technology and orientation towards new markets. Policies should be so designed that they provide incentives and means to firms to adopt a strategy which can result in better performance.

If firms are to be able to export they have to be competitive. The quality of the investment climate is a central factor. Rwanda has an extremely poor infrastructure and a relatively weak regulatory system, which puts it at a disadvantage even within Africa. Reforms to improve market institutions such as laws, courts, business associations, lobbies, quality control, and protection of property rights and enforcement of contracts have begun, but the process has been slow. The road ahead needs to be defined as clearly as possible. Financial institutions that provide insurance, hire-purchase/leasing of equipment and vehicles, merchant banking services, letters of credit, bonds, hedging instruments etc. are weak in Rwanda. Commercial and business services, e.g. in the provision of warehousing, transport, utilities, auditing, marketing, market prospecting, export promotion, product design and maintenance need to be developed.

So the list of things that need to be done is long, but not all reforms need not be done at once. Actually, they should not be done all at the same time. Production costs need to be reduced for firms to become competitive, but this can be achieved with the help of some reforms and innovations but not all. So what should be done in PRSP2 is to identifying what improvements can be introduced at lowest local cost is the first step. Growth efforts can be focused on some specific sector and/or a specific location to save money. This makes it more likely that productivity will be increased enough to make firms competitive. To spread the country's meagre resources across a multitude of sectors and locations is not cost efficient.

In Rwanda, as elsewhere in Africa, there is a sizeable informal sector (Bigsten, Kimuyu, Lundvall, 2004). This will for an extended time be an important part of the survival strategy of poor families, and policies must therefore not discriminate against such firms. Eventually some informal firms should be able to become formal, and an issue is how policy makers can best facilitate such a transition process. One reason for being informal is that it is costly to be formal, and there are often problems in dealing with authorities relating to regulatory red tape, corruption, and lack of security. By being informal firms can largely avoid these problems. Addressing basic investment climate issues would therefore be positive also with regard to the transformation of the informal sector. Measures that help the informal firms to become more productive are in themselves important, but capacity-building efforts in areas such as vocational training often neglect the informal entrepreneurs and their employees. Innovative methods are needed to improve access to credit for small firms with an ambiguous legal status and lack of proper accounts.

The basis for the forthcoming PRSP must continue to be a macroeconomic policy that is credible to domestic and international investors. Uncertainty is a major factor in explaining low investments among African manufacturing firms, and efforts to maintain stability are therefore very important for investment. The government must be able to resist temptations to reverse the policy and pursue populist policies. If growth can be sustained, and few countries in Africa have been able to do so, there should be upward social mobility leading to reduced social tensions and thus less pressure for populist measures.

9. Concluding Remarks

We started by characterizing Rwanda as a landlocked and highly polarized society. In this difficult environment the country is trying to create a stable environment for growth and poverty reduction. The proponents of the notion of an African poverty trap argue that a huge aid injection can put Africa on a sustainable growth trajectory, but critics are concerned about the ability of African governments to handle at least some types of aid expansion. Implementation of policies is at present the main problem in Africa, not their formulation. This also applies to the case of Rwanda.

The poverty impact of economic development depends on the rate of growth, the initial income distribution and its change. The work on the poverty impact of growth suggests that the relative importance of growth is higher in low average incomes and low inequality countries. Rwanda is a country with very low incomes, so although it also suffers from relatively high inequality growth must be a high priority if it is to be able to achieve sustainable poverty reduction. This is the reason for the focus on growth in this report. We also note, however, that distributional considerations are of special importance for Rwanda, since redistribution measures may be help reduce social tensions and keep the peace.

When comparing with other Africans states we find that Rwanda has incomes somewhat below the SSA-average after a strong recovery since 1995. We find that Rwanda is exceptionally dependent on agriculture and highly subsistence oriented. Export revenues are tiny and foreign savings essentially finance all of Rwanda's investment.

The first PRSP set out a highly ambitious programme to reduce poverty in Rwanda. The main components were rural development and agricultural transformation, human development, investment in economic infrastructure, good governance, private sector development, and institutional capacity building. The aim was to achieve an economic growth rate of 7–8% per year and thereby achieve rapid poverty reduction.

So what was achieved during the Poverty Reduction Strategy epoch 2002–2004? Growth has been quite fast in Rwanda, although there was a setback in 2003 due to drought. We made a crude estimate of the change in poverty between 2000 and 2004. Our estimate indicates that poverty as measured by the headcount index declined from 60.2 to the span of 53.5–55.8 The average growth rate is, however, far below the target of 7–8% set in the PRSP. There has been moderate slippage in macroeconomic policy, leading to some acceleration in inflation. Whether this is serious enough to have had negative effects on growth is unclear. There are no indications that a transformation of the economic structure in Rwanda has begun in earnest. The country remains one of the most inward oriented countries in the world with an export share of GDP below 8%. The economy remains largely donor driven.

Rwanda is thus a highly aid-dependent country. It can be regarded as a country with relatively good policy and governance, but a key issue is whether the country can effectively absorb more aid that it does at present. Some forms of investment in infrastructure could probably be undertaken without creating severe absorption problems.

The main concern for long-term poverty reduction is what happens to the productive sectors. Unless they grow, there will be no basis for welfare measures in the future. The most important productive sector in the economy is agriculture. Progress in terms of output and export is so far modest, and the countryside remains highly subsistence oriented and undiversified. This is the reason for the plan to launch a comprehensive integrated rural development scheme to be coordinated by the Ministry of Agriculture. Even if the aims are worthy, the experiences of such efforts in countries with better administrative structures than Rwanda are very poor. This is an example of plans that demand more administrative skills than the system can deliver. With regard to private sector development there is intensive work in the form of the production of plans and strategies, but implementation is slow and significant impacts on in terms of increased production and export is yet to be seen. Investment in productive capacity in the private sector by domestic investors is low, and foreign direct investments apart from those related to a few privatisations are virtually non-existent. Progress is being made with regard to cleaning up the business environment, but still foreign observers rank the business environment as one of the worst in the world. This will have to be changed, if the country is to be able to attract foreign investors. The low level of industrial investment is reflected in the lack diversification of exports. In spite of some progress with regard to trade policy reforms, this has as yet not lead to any significant export. The competitiveness of Rwandan firms is not such that it can compensate for cost disadvantages due to the poor infrastructure and the inefficient administrative structures in the country.

When it comes to human development interventions there has been considerable progress under the PRS. This was also the area that was given most attention in PRSP1. There has been a very impressive expansion in school enrolment, and there have also been some improvements in the delivery of health services. With regard to health, however, it seems as if the outcome variables have not developed as hoped, for example due to HIV/AIDS. The health sector will therefore require even more resources in the future. With regard to economic infrastructure investments have increased, but given the precarious starting point much remains to be done. In particular, if the country is going to get out of its state of economic isolation it will have to link up with the world. This will require huge investments in both road, and possibly train, transport as well as investments in the international airport from were for example horticultural products can be exported. Also energy supplies are critical for growth, and hopefully there is some realism in the methane-plans.

The government's financial and budgeting systems have improved a lot over the last few years, and there is reasonable control over the financial aspects of the budget performance. The physical monitoring of outcomes and the reporting and analysis of actual outcomes remains weak, however. Since the idea behind the new budgeting system was that there would be feedback on the basis of which polices were to be revised, the weakness of this part of the system is worrisome. There is also a serious concern about the ability of the government administration to cope with the ever increasing demands that is put on it. Neither the competence nor the incentives are sufficient. We argue that there is reform overload. There is a need to focus on administrative reform and fewer tasks.

Interviewed persons

Mr Leonard Rugwabiza, Directorate of Strategic Planning and Poverty Reduction Monitoring, Minecofin

Mr Roch Ahoumou, MTEF coordinator, Minecofin

Mr Philippes Gafishi. Director of Statistics, Minecofin.

Mr Musoni J. Rutayisire, Director of Studies and Statistics, National Bank of Rwanda.

Mr Celestin Sekagilimana, Director, Balance of Payments, National Bank of Rwanda

Ms Vivian Mwitirehe, Department of Foreign Exchange, National Bank of Rwanda

Mr Ernest Ruzindaza, Director of Planning, Ministry of Agriculture

Mr James Foster, Ministry of Commerce and Industry

Mr Arne Ström, Head of Development Co-operation, Swedish Embassy, Kigali

Ms Sandra Diesel, Programme Officer, Swedish Embassy, Kigali

Ms Katrine Larsen, Second Secretary, Swedish Embassy, Kigali

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Mr Cormack Quinn, Programme Manager, Dfid in Rwanda

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Mr Tom Leeming, Economist, Delegation of the European Commission in Rwanda.

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