Rwanda

Rwanda Looking Ahead: Reconciliation, Reform and Regional Stability

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This report has been prepared by Steve Kayizzi-Mugerwa.

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ACRONYMS

AfDB African Development Bank
AIDS Acquired Immune-deficiency Syndrome
CEPEX Central Projects External Finance Bureau
Dfid Department for International Development (United Kingdom)
DRC Democratic Republic of the Congo
ESAF Enhanced Structural Adjustment Facility
Ex-FAR Former members of the regular army
FRw Rwandese francs
GDP Gross domestic product
HIPC Highly Indebted Poor Countries
IDA International Development Association
IMF International Monetary Fund
MDTF Multilateral Debt Trust Fund
MINAGRI Ministry of Agriculture
MTEF Medium term expenditure framework
NGOs Non-governmental organisation
NPV Net present value
PIP Public Investment Programme
RPA Rwanda Patriotic Army
RPF Rwanda Patriotic Front
RRA Rwanda Revenue Authority
Sida Swedish International Develoment Cooperation Agency
SIPs Sector investment programmes
UNDP United Nations Development Programme
UNICEF United Nations Children and Education Fund
UPE Universal primary education
USAID United States Agency for International Development
VAT Value added tax
WFP World Food Programme

EXECUTIVE SUMMARY

This study reviews Rwanda's socio-economic challenges within the perspective of the civil war and the genocide and the government's attempts to transcend them via national integration, reconciliation as well as economic reform. After a period dominated by humanitarian aid, Rwanda has embarked on a transition towards the longer-term concerns of sector restructuring via public sector and market reforms, including privatisation. The transition is hampered by four gaps or deficits: the first relates to the fragile peace, the second to lack of human resources and the third and fourth to balance of payments and the fiscal imbalances, respectively.

The return of peace has been important for Rwanda's economic recovery, enabling the government as well as the donor community to undertake interventions in a number of sectors and regions. As a result, the country has made remarkable progress in some areas, for example, with respect to macroeconomic stability, increasing food production, the rehabilitation of industry and infrastructure, and, in the social sector, with respect to the number of children attending school and those receiving immunisation. Given the complexity of the Great Lakes crisis, however, peace remains fragile. Continued external security threats imply that the government cannot lower military expenditures by much, even though having a cost in terms of lower social expenditures and held back aid disbursements. Still, international efforts at bringing peace to the region seem to be taking hold, with a positive effect on security.

Lack of human resources is a very serious constraint on Rwanda's development in most areas; it lowers the pace at which the population can be mobilised in the fight against poverty. The bulk of the civil servants are poorly educated, lacking administrative and managerial skills. This has made reform measures difficult to implement, affecting the delivery of services in both urban and rural areas. In education, only 32 per cent of primary teachers are qualified while 22,000 primary teacher positions remain vacant countrywide. To eradicate these gaps will demand a broad-based strategy that will include support to training institutions to enhance quality and also encouraging professional training, involving the private sector as well as the government.

Part of the problem in the past was lack of incentives in the public sector: social sector workers received relatively low wages, and their career paths were poorly defined. The functional restructuring of the public sector currently taking place, as well as efforts at improving wages might help raise morale and productivity in the civil service. This will in turn improve the sector's capacity for social intervention, especially directed at poverty reduction, and for managing development programmes.

Rwanda's fiscal gap and balance of payments deficit are closely intertwined. To augment the narrow tax base, high taxes were imposed on foreign trade in the past, with negative incidence on the export sector, notably coffee farmers. However, fiscal deficits will be difficult to eliminate since the tax base is small, while the government should not over tax the fledgling private sector. Still, there is scope for improving the taxation effort and the Rwanda Revenue Authority is bound to play an increasingly important role although, as in the case of neighbouring countries, the beginning, which involves establishing a non-coercive tax culture, is often difficult.

With respect to exports, Rwanda's tea commands a premium in international markets although its coffee production has declined due to poor incentives and an aged tree stock. With the privatisation of associated businesses, tea production is bound to expand while the introduction of high-yielding varieties is bound to boost coffee production in the medium term. There is also scope for cereal production for home consumption as well as for export. But this demands the adoption of technology intensive techniques: notably the introduction of enhanced seeds. Intensive as opposed to extensive agricultural production is also high on the policy agenda.

In spite of its rapid recovery in the past five years, Rwanda still has few means of meeting the vast needs of its poor and vulnerable groups. Therefore, donor funding of the budget and the balance of payments will continue to be important. Thus the question is not so much how to reduce aid dependence as how to put the aid inflows to good use, via better co-ordination and minimisation of their sometimes negative impact on incentive structures in the civil service. Rwanda is a good test case of the donor community's willingness to 'reward' African governments, via the HPIC process for example, that, under severe domestic pressures and constraints, have kept on the path of reform, returning their countries from disaster to relative normalcy.

1. Introduction

Following the genocide of 1994, Rwandan policymakers have sought to address the negative socio-economic impacts by promoting national integration, reconciliation and security while at the same time embarking on policies to reverse the legacy of structural imbalances, economic disincentives and institutional inertia from earlier decades. But while Rwanda's economic challenges resembled those of its neighbours in the Great Lakes region, which also have experienced long-term economic decline, its preconditions for political reconciliation and economic reform set it apart. Policymakers embarked on economic reform with a minimum of financial and human resources, with collapsed local administrations and disrupted rural livelihoods, and generally with poor means of enforcing policies. The new administration was also confronted by armed opposition, stationed across the border, which proved to be the beginning of a burgeoning regional crisis in the Great Lakes region.

This report thus focuses on the '3rs': reconciliation, reform and regional stability, which will determine the extent to which Rwanda manages to return to sustainable growth. National reconciliation is necessary to ensure peace, without which little can be achieved politically or economically. Economic reforms, on the other hand, are important not only in enabling the country to enhance its agricultural productivity, create employment and reduce poverty but also to activate and expand the small and scattered internal market, and encourage savings and investment. There is also need to raise public sector efficiency, resuscitate the infrastructure and provide support to the fledgling private sector. With regard to the region, recent events have shown that countries of the Great Lakes basin are bound by a similarity of concerns: economic, political and military. For a small land-locked country like Rwanda, regional co-operation and security have a close bearing on its development, as does access to regional markets and infrastructure. In the short to medium term, policymakers have also had to manage the transition from emergency and humanitarian actions of the mid-1990s towards measures to ensure long-term development.

The purpose of this report is to undertake a review of the socio-economic challenges confronting Rwanda at the end of the 1990s and, within the perspective of the government's current efforts at economic and political reform, to attempt a tentative appraisal of the medium-term prospects. These intentions are presented more explicitly in the four points below:

1. To review the macroeconomic reforms and outcomes of the past five years, following the genocide of 1994 and the economic decline and civil war that preceded it, with a focus on monetary and fiscal developments as well as on the impact of aid inflows and the debt escalation.

2. To review the structural adjustment process, including public and financial sector reforms, as well as policy changes in agriculture and rural development.

3. To look at poverty in Rwanda, which reached a peak after the genocide, and the impact on it of current expenditure policies, especially in the social sector.

4. Last, the report attempts to put Rwanda's medium-term prospects within the economic and security challenges confronting the Great Lakes region.

2. Economic decline and genocide

2.1. Introduction

The atmosphere of intolerance and political hysteria that preceded the genocide of 1994 was sustained by the in-ward looking policies of an entrenched and politically exclusive dictatorship, and aggravated by the socio-economic pressures engendered by the economic decline of the preceding decade. Rwanda's combination of high population growth, limited land resources, falling agricultural productivity, and a historical/colonial legacy of ethnic tension had raised the risk of communal conflict. In this section, we look at some of the causes of the economic decline of the 1980s and early 1990s.

2.2. Smallholder agriculture was constrained by policies and land shortage

Smallholder agriculture on which the bulk of the population depends in Rwanda was, long before the genocide, characterised by severe land scarcity, declining land productivity, poverty and hunger (see for example Clay, Reardon and Kangasniemi 1998). As a result of rapid population growth, the traditional agricultural system had come under serious stress. Farm-holdings became smaller and fragmented, especially in the overpopulated prefectures, and recourse was taken to more marginal land, which led to soil and other environmental degradation. Poor land legislation and weak enforceability of legal statutes led, in turn, to insecurity of tenure. Landless families were often unable to rent sufficient amounts of land for themselves, while there was little tradition for farm labouring, sometimes considered by Rwanda's self-reliant peasants as socially degrading.

Given land shortage and general lack of capital, farmers in Rwanda chose labour intensive forms of adaptation. Fallow periods were reduced, while farming on steep slopes also increased. As noted by Clay, Reardon and Kangasniemi (1998) this type of intensification led to further soil degradation and further productivity declines, especially in a climate characterised by heavy rainfall. Long-run ecological degradation led to chronic poverty, with some areas barely able to sustain sufficient food production. Some regions of the country were thus already engulfed in poverty's vicious circle by the end of the 1980s.

The government's agricultural policies had important negative impacts as well. As in other African countries, price controls were a key feature of agricultural policy. Related trade and labour mobility restrictions made rural activities even more inflexible. However, while in some of the neighbouring countries they were not rigorously enforced or, where they were, led to smuggling so that farmers still were able to stabilise their incomes, in Rwanda farmers, for lack of markets, reverted to subsistence production. But among the most serious shortcomings of government policy was failure to promote agricultural innovation via the introduction of new technologies in farming, extension services and infrastructure. With traditional production technologies, expansion of land under crops was the only means of raising output. However, given land shortage, this hardly was a feasible option for Rwandan smallholders.

2.3. *The macroeconomic environment deteriorated after the mid-1980s*

In Table 1 we have laid out selected figures on economic performance covering the period from 1980 to 1994. In the 1970s, Rwanda had performed well, in some respects much above the African average. This was also reflected in its social indicators. Infant mortality (per 1,000 live births) had, for instance, fallen from 142 to 120 in the early 1980s. Though still above the African average, it was one of the fastest rates of improvement during the decade, also reflected in higher life expectancy. Access to safe water, a useful welfare indicator, also showed vast improvement during the seventies, reaching 80 per cent in urban areas and 66 per cent in rural ones, in both cases above the African averages. The foreign debt to GDP ratio was only about 21 per cent in 1985, while the debt service to export ratio was a manageable 10 per cent. Rwanda's external debt had thus, compared to its neighbours, not yet become a serious problem.

However, Table 1 shows also that in the 1980s the economy already had entered a period of much slower growth, averaging a mere 2.7 per cent between 1980-85, compared to 6.4 per cent in the second half of the 1970s. Thus for the majority of the population, economic welfare, estimated by per capita income, had stagnated, with serious downward income trends in the traditionally poorer regions to the north-east.

During the period 1986-1990, per capita incomes fell by over 1 per cent per year, so that by the end of the decade the population as a whole was poorer than at the beginning. A major cause of declining growth was the low level of investment. Although total investment as a per cent of GDP had reached a peak of 17 per cent in 1985 (with GDP itself estimated at about US$ 1.7 billion), it only averaged below 14 per cent over the first half of the 1980s. Over the next period, 1986-90, it was not possible to raise investment to levels much beyond this.

As already indicated poor agricultural performance was one of the main causes of the economic downturn. Agricultural output increased by only 1.2 per cent per year during 1980-85, indicating negative per capita agricultural production. This worsened in the second half of the decade as poorer weather, falling soil productivity and lack of price incentives, lowered yields.

Although Rwanda's civil services seemed to have been spared the ravages and decline experienced by its neighbours in the 1980s, it too had undergone a slow deterioration. Apart from the declining standards of training, the incentive structure (wages and terms of service) was also becoming unattractive. Thus in spite of the increase in inflation, the government had not bothered to adjust its minimum wages for a period of up to 15 years (1980-95). In 1980, the lowest grade of unskilled labour in the public sector earned about 2500 FRw, which translated into about US$27. Fifteen years later, the wage was only equivalent to 9 dollars. In real terms, the purchasing power of the unskilled labourer had fallen by much more. Even high level technicians, considered well paid by public sector standards, saw their monthly wages decline from the equivalent of US$340 in 1980 to $121 by 1995. In many African countries poor remuneration saw workers losing morale and resorting to all sorts of tricks in order to make ends meet, including corruption and privatising parts of the public services. It is clear, that similar problems were beginning to afflict Rwanda by the mid-1980s.

In monetary terms, and largely because a cap was put on public sector wages, the government seems to have managed to put a lid on inflationary pressure by pursuing relatively restrictive expenditure policies. Claims on government by the banking system were for example negative in the early 1980s, remaining relatively small for the rest of the decade. Inflation thus remained below 5 per cent on average. However, the inflation picture changed drastically at the beginning of the 1990s as the country became engulfed in civil war, with disruptive impacts on production and distribution of goods and services. Inflation rose to 20 per cent in 1991, although it then declined to about 10 per cent in the following two years. This more favourable development was due to improved weather conditions, which raised agricultural output. It rose by 5 per cent in both 1991 and 1992, but then fell by 15 per cent as the civil war escalated in 1993.

Table 1: Selected Indicators of Economic Performance 1980-94 (average growth and ratios, %)

	1980-85	1986-90	1991	1992	1993	1994
GDP growth (%)	2.7	1.4	-4.5	8.4	-10	-50
Per capita income growth (%)	0	-1.3	-7.2	5.7	-12.7	-50
Investment/GDP (%)	13.7	14	9	10	9	11
Agricultural output (%)	1.2	-1.3	5.3	5.3	-15	-42
Inflation (%)	4.5	2.1	20	9.2	12.7	64
Exchange rate $/FRw (nomin.)	95.6	81	125	133	144	220
Financial vulnerability (%)*	63	29	36	26	12	2.3
Resource balance/GDP (%)	-12.3	-11.8	-23	-22	-30	-83

Source: World Bank (1998c), Banque Nationale du Rwanda (1999b)

* Financial vulnerability is here simply measured as a ratio of net foreign assets to M2, the closer the figure is to 100 % the more 'foreign cover' there is for domestic currency, and the less pressure on the exchange rate.

The shortages and disruptions associated with the civil war led to the depreciation of the Rwandan franc. In the circumstances this did not stimulate exports or lower the excess demand for goods and services. Table 1 shows that the resource balance (or trade gap) to GDP ratio increased in absolute terms, as exports of coffee and tea, some of it grown in areas disrupted by the civil war, declined while imports (including those of ammunition) increased or changed little, financed by the continued willingness of some creditors to avail funds. The government also had negotiated an adjustment credit with the World Bank in the early 1990s which ensured access to foreign exchange.

It can also be noted that the country's financial vulnerability was increasing. Thus at the current exchange rate, the foreign exchange reserves available were not enough to meet the domestic demand for imports; controls on the current account were accordingly tightened.

2.4. Transcending the Genocide

In the middle of 1994, while the guerrilla army, the Rwanda Patriotic Front, was marching on Kigali, the regime, its leadership newly disrupted by the death of the President, embarked on the massacre of close to a million people, with help from a people's militia (*interahamwe*), trained and equipped for the purpose. The genocide was directed mainly at the Tutsi part of the population, although many 'moderate' Hutu people as well as their families met a similar fate. The genocide set off a series of events with which the country and the region itself are yet to come to grips.

One of the most disruptive economic and security impacts, and which was to prove an important test of the new leaders determination, was the large-scale inward and outward migrations that followed the genocide of 1994. In its wake, and following the assumption of power of the Rwanda Patriotic Front (RPF) in Kigali, a vast number of people fled Rwanda to the DRC. These included members of the defeated army (ex-FAR), those of the ousted government, as well as members of the *interahamwe*, with their families and dependants. However, while a majority of refugees fled for fear of reprisals, and in search of security in numbers, in the refugee camps they came increasingly under the control of a core of former politicians and military officers that was opposed to the new rulers in Kigali. This would prove a most destabilising development (See for instance DANIDA, 1996, Misser 1996, 1995).

Almost simultaneously, a large number of 'old case load' refugees: that is refugees who had fled Rwanda under earlier civil strife returned to the country in a more or less spontaneous manner. For example, a number of returnees from Uganda came with vast herds of cattle, settling in the north-east of the country, in the midst of a national game park, thus putting an already fragile area under more environmental pressure. In 1997, following the outbreak of war in the DRC that eventually forced out the Mobutu regime, the refugees returned en-masse from their camps in Goma, while smaller numbers also returned from Tanzania. Aside from these cross-border movements, there has also been internal migration as well in the last couple of years. With the resumption of war in the DRC in July 1998, this time against Kabila, the *interahamwe* resumed its incursions into the north-western parts of Rwanda, worsening the security situation there. The government has had to resettle a large number of families in safer zones of the country.

Table 1 shows that the year of the genocide, 1994, saw a 50 per cent decline in GDP, mainly a result of the fall of agricultural production, by 42 per cent in that year alone. Besides the unprecedented loss of life, the genocide also led to severe loss of property, social contacts and entitlements. The supply of social services deteriorated along with the economic infrastructure. Inflation rose to 60 per cent, but could have risen even higher had the ousted government not absconded with the bulk of the currency at the Central Bank, which had the impact of a monetary contraction on the rest of the economy. One of the most serious legacies of the genocide was, however, the loss of manpower in both central and local governments. This loss of human capital and institutional memory in the civil service made the transition extremely difficult.

To guide the country through the period of transition, the government devised a set of interrelated short-term goals. They were as follows:

- Restore and maintain peace
- Revive physical investment
- Improve human resources via improved education and training
- Ensure a rapid return to macroeconomic stability
- Rehabilitate institutional capacities and highlight justice and governance issues

The seriousness projected by the government in the year following 1994 won it much support in donor circles. But it still had to confront tough situations and to make difficult choices (see for instance Republic of Rwanda, 1999a,b&c). First, before the country could stabilise economically, high amounts of foreign assistance were needed. However, the timing and size of the inflows have themselves been a source of budgetary instability. They were invariably delayed with the attached conditionalities shifting with Rwanda's political and security realities. Second, the security situation at the border with the DRC remained fluid as the expelled soldiers sought to regroup. This diverted national efforts at reform. Third, while there is much evidence on how poor countries respond to economic reforms, that is slowly and with difficulty, there was preciously little knowledge on how a country which had lost over 10 per cent of its population would respond. There was thus a 'leap in the dark' feeling about the policy steps undertaken in the first year following the genocide.

Two aspects, aside from foreign aid, might explain Rwanda's relatively rapid recovery from the immediate effects of the genocide. The first must be the relative efficiency of the transition government. Leadership in the line ministries comprises a number of technocrats, flexible and well versed in the ways of the multilateral agencies as well as the language of reform. How the new government dealt with the issue of changing the national currency is illustrative. While currency changes are often for monetary reasons, in the case of Rwanda the switch also had a security purpose. It is estimated that members of the former government had managed to escape to Goma with over 30 billion francs, comprising well over two-thirds of base money (they left behind only bills of 100 francs and below as well as coins).[1] This money was used not only to keep the former rulers in relative comfort but, even more important, enabled them to pay their soldiers (ex-FAR). The rapid change of currency in Kigali (the exercise was over in three days) thus dealt a severe blow to the latent powers of the exiled rulers, while it also increased confidence in economic policy in Kigali. There has also been much flexibility in dealings with donors. To expedite funds pledged at the Roundtable conference in Geneva at the beginning of 1995, for example, the government agreed to the setting up of a 'permanent control unit' in the Ministry of Planning that would be run jointly with donors in order to ensure compliance.

Second, since the genocide had totally discredited the ousted government, the new one was able to embark on reform without too much political opposition and related encumbrances. The new leaders in Kigali espoused clean politics and vowed to focus on poverty eradication, participatory government, and national reconciliation: attractive propositions domestically and from the point of view of donors. Although ultimately proving pre-mature, for a time the international press talked of the emergence of a new breed of leaders in the Great Lakes region.

[1] It is said that Rwanda had in effect two exchange rates at the time, a controlled one in Kigali and a free and very depreciated one in Goma and surroundings.

2.5. Conclusion

Thus economically, the events of 1994 implied a massive shock: assets and markets were destroyed, producers and consumers killed, while government departments worked inefficiently for lack of finances and personnel. Social cohesion in the countryside was damaged, perhaps irreparably. Initially, a vast amount of humanitarian aid was needed to confront the horrors of the genocide and to enable Rwanda embark on a process of national reconciliation. However, Rwanda had experienced a decade-long economic decline before the genocide, characterised by falling investment, collapsing agricultural productivity and widespread malnutrition. These negative trends needed to be addressed as well. In the post-emergence period, the donors began demanding that military expenditures be slashed in favour of the social sector. Given the poor finances, the various budgetary demands, security, poverty eradication and national reconciliation are bound to compete. The policy challenge lies in reconciling the competing demands while keeping in mind the need for continued donor support.

3. Macroeconomic reforms in the era of transition

3.1. Introduction

As noted above, the transition government had managed to establish a degree of security and military stability by the end of 1994, enabling it to embark on macroeconomic reforms, infrastructure rehabilitation and public sector re-organisation. Given the extent of economic disruption as well as the physical and social calamities that had befallen the population, Rwanda requested and received a considerable amount of foreign aid. Not unexpectedly, therefore, the impact of aid flows on both the economy and politics of the country has been one of the most important factors during the years of transition. Although humanitarian aid was relatively free of hard conditionalities, it nevertheless had implications for the government's budgetary process so that delays and alterations affected public sector activities.

The management of increased aid inflows also revealed that the public sector had insufficient resources for efficient aid absorption. Moreover, with regard to macroeconomic outcomes, large aid inflows led to the appreciation of the real exchange rate, slowing down the recovery of the traditional export sector. Another important source of economic instability during the transition was the military, diplomatic (especially in relation to aid flows) and budgetary implications of the DRC crisis.

3.2. Reforms and Performance 1995-99

At the beginning of 1995, a large donor conference was held in Geneva (Geneva Roundtable) during which pledges of assistance worth close to US$800 million were made. At the suggestion of Holland, and partly to overcome the capacity constraints in government, a UNDP Trust Fund was set up in February, to manage these funds, with the Dutch as by far the biggest single contributor. By the end of the year, however, only about half of the pledges had been disbursed. This slow pace of disbursement was variously blamed on weak absorption capacities of the Rwandan government as well as on the donors' reluctance to disburse in light of human rights violations, notably the violent incidents in the refugee camps in April 1995. The UNDP adopted a 'direct execution' policy to enable speedier and more flexible implementation. This meant that many NGOs were brought in during the implementation process. This proved useful during the refugee crisis of 1997 when a million refugees returned home.

Since initially Rwanda was in more need of humanitarian assistance than economic reforms, the Bretton Woods Institutions did not come on board until 1995, when Rwanda received assistance from the IMF's post-conflict emergency facility as well as two quick-disbursing credits from the World Bank. The government then followed a 'shadow' IMF programme through 1996 and 1997. During 1998 and 1999, Rwanda reached a three-year ESAF arrangement with the Fund, a structural adjustment credit with the African Development Bank (AfDB) and an Economic Recovery Credit with the World Bank. Grants were also extended by the European Union (EU) and bilateral donors (IMF, 1998a, IDA, 1999, Dfid, 1998).

Macroeconomic Outcomes

Rwanda's economic development between 1995 and 1999 (Table 2) has been high but as already indicated, from a very low base (see Table 1). During 1995, a year after the genocide, Rwanda registered a growth rate of close to 37 per cent, thanks to donor-funded humanitarian and reconstruction activities. Growth then fell to 16 per cent in 1996, 13 per cent in 1997 and an average of about 9 per cent during 1998-99. It is projected that growth might settle down at a more sustainable 6-7 per cent in the next decade. The greater part of the growth since 1995 thus amounted to a 'peace dividend', that is that increases in production depended more on the return of peace, enabling, for example, peasants to return to their farms or to reach markets, than on increased investment. Indeed for most of this period, total investment remained below 13 per cent of GDP (Table 2).

The government has also been successful in its stabilisation policy. Inflation fell from 64 per cent (see Table 1) in 1994 to an average of about 7 per cent in the last couple of years. This has been mainly thanks to the government's ability to keep monetary growth within agreed limits, for example broad money (M2) grew moderately, remaining at about 15 per cent of GDP after 1995. This in turn was enabled by the fact that donors have been willing to meet not only Rwanda's capital budget, but also a substantial part of its current expenditure. Still although the government had thereby a small fiscal deficit (about 2 per cent of GDP) enabling it to avoid borrowing large amounts from the banking system, revenues averaged only 10 per cent of GDP, far below the African average of close to 18 per cent. By 1998, it is estimated that the economy had returned to about 85 per cent of its pre-genocide level. Rwanda still needs to maintain high levels of growth through the next decade if it is to be able to reduce poverty and create an environment favourable to national reconciliation and increasing welfare.

Table 2: Macroeconomic indicators 1995-99 (% change, ratios)

	1995	1996	1997	1998	1999*
GDP, growth (%)	36.8	15.8	12.8	9	8.1
Investment (% GDP)	8.6	10.3	10	9.9	16
Private inv. (% GDP)	0.7	1.1	1.8	3.4	6.5
Current revenue (% GDP)	9.5	10.0	9.6	10.6	10.9
Current expenditure (% GDP)	12.1	12.6	11.0	13.4	13.3
Current fiscal deficit (% GDP)	2.6	2.6	1.4	2.8	2.4
Money/GDP (%)	18	16	15.5	15.2	15
Money (M2) growth (%)	68.5	8.3	21.6	13.6	12.7
Exchange rate ($/RFw)	262	306	304	316	340
Terms of trade change (%)	37.3	-15.9	15	-13	-11
Inflation (%)	22	8.9	12	6.8	5

* estimate
Source: Banque Nationale du Rwanda (1999b), Republic of Rwanda (1998a), World Bank (1998c)

Aid inflows were putting upward pressure on the real exchange rate so that the nominal exchange rate shown in Table 2 showed relatively less depreciation than the growth of inflation and deterioration in the terms of trade would have warranted. Though the government introduced foreign exchange bureaux, a black market for foreign currency still persists. This is mainly because the government controls the capital account, while funds provided within the bank system require documentation for importers, and thus with tax liability implications. The exchange rate premium at the parallel market is thus the 'price' being paid for the remaining controls.

A measure of control also characterises interest rates as shown in Table 3, with maximum-lending rate guidelines still used. However, here some of the rigidities are due to the credit distortions caused by the genocide. Many firms became distressed on loss of their management, owners, as well as customers. Although the government encourages banks to supply credit to agriculture at favourable terms, notably in the form of crop financing, the credit going to agriculture and the rural sector remains very small (see also below). In a liberalising environment, the government has little means of targeting private sector credit.

Table 3: Commercial Bank interest rates June 1996 to June 1999 (%)

	6/1996	12/1996	6/1997	12/1997	6/1998	12/1998	3/1999	6/1999
Bank deposit rate (1 year)	10.3	7.6	8.7	11.3	10.4	10	9.8	9.8
Max. lending rate	19	19	19	19	19	19	18	18
Crop credit rate	18	18	14.5	16	14.5	16	-	-
Interbank rate	-	11	9.3	8	8	8	8	8.4

Source: Banque Nationale du Rwanda (1999b)

Balance of Payments and Debt

In Table 4, we present figures on the balance of payments and foreign debt. Rwanda's export sector is small, based on coffee and tea, with some hides and skins and recent attempts at horticultural exports. Coffee and tea exports have accounted for about 80 per cent of total exports since 1995. This imbalance is, however, part of the traditional structural problems of the country and was not caused by the civil war or the genocide. However, as noted above, the aid inflows have tended to depress the incentive for exporting, as they have appreciated the Rwandan franc in recent years. The impact of aid inflows on the balance of payments is best seen by comparing the current account before aid receipts and after. Without aid inflows, Rwanda's current account deficit would have averaged 18 per cent of GDP between 1995 and 1999, to be compared to 4 per cent with aid. While Rwanda needs all the assistance it can get, the 'dutch disease' impacts of the inflow as well as the increasing unpredictability of the disbursements are causing government concern (See Budget Speech, 1998).

Table 4: Balance of Payments and Foreign Debt (US$ mn, %)

	1995	1996	1997	1998	1999*
International reserves (months of imports)	5	5	5.4	6.2	6
Export (US$ mn)	50.4	62	93	62.4	70.9
Of which: - coffee and tea (%)	82	85	66	80	78
Import (US$ mn)	194	213	277	261	328.3
Of which: - capital imports - intermediate imports - food	 25.8 20.7 28	 25.3 25.7 23.7	 22.4 25.5 19	 23.3 26 19	 29 26.8 15.5
Current acc. balance (% GDP) - without official transfers - with official transfers	 -20.5 4.5	 -19.1 -0.3	 -17.3 -3.2	 -16.8 -5.0	 -18.5 -7.2
Foreign financing/GDP (%)	11.4	10.0	13.5	16.5	10.9
Foreign debt (US$ mn)	1064	1110	1176	1239	1450
Debt stock/GDP (%) Debt service after debt relief (% exports)	88.6 54.4	79.6 44.4	62.7 24.8	59.3 26.1	62.2 34.3

*estimate

Source: Banque Nationale due Rwanda (1999), Republic of Rwanda (1999), World Bank (1998a, 1999b&c)

Still, it is difficult to see how Rwanda could lower its dependence on donor funding to any significant degree in the short to medium run. Exports, at about US$65 million per year, currently 'cover' only about 20 per cent of total imports. There have also been incentive problems: for lack of revenue, coffee exports were taxed as recently as 1999, while high fuel taxes raise transport, and therefore export, costs. After several decades without replanting, the coffee trees are aged, with extremely low productivity and need to be replaced by enhanced varieties. Tea production for export is said to be more promising, especially since Rwandan tea commands a premium on the international market, used to blend inferior teas. Thus it is hoped that the recently completed privatisation of tea factories and estates will stimulate investment in the sector and raise production.

Given Rwanda's varied climatic zones, 'non-traditional' exports crops such as flowers and vegetables are very promising. Still, a cheap and stable means of transport to the European markets is yet to be found, too few airlines currently fly the Kigali-Europe routes, although regional connections are plentiful. Thus the government is also emphasising the export of cereals, notably rice and maize, to regional markets.

With respect to the structure of imports, Table 4 shows that capital and intermediate imports have together dominated the total, which is a direct result of the rehabilitation and expansion work undertaken during the past few years. Food imports have also featured prominently, especially since the country has suffered food deficits from the 1980s, aggravated by the crises of the 1990s. Rwanda has, nevertheless, been able to effect a level of trade liberalisation in recent years, with a relatively free foreign exchange market and sharp reduction in tariffs.

Rwanda's limited export capacity relates directly to its serious debt problem. The country's foreign debt amounts to US$1.45 billion, the bulk of it (83 per cent) owed to multilateral institutions (mainly the World Bank, IMF and the African Development Bank). About 14 per cent of the debt is owed to bilaterals, while 3 per cent is owed to commercial interests, and is mostly short term. As in other African countries, the debt stock is much bigger than the country would ever be able to repay. However, many African countries have simply neglected repayments, piling up arrears with the multilateral institutions and at the Paris Club. The danger with this strategy is that countries then lose access to the cheap IDA loans and the goodwill that comes from a well arranged, donor supported reform programme.

During the course of 1998, Rwanda reached agreement on a flow rescheduling, on Naples Terms, of all arrears and maturities on pre-cutoff debt.[2] During a donors' conference in Stockholm in June 1998 a total of US$250 million in assistance was pledged, including US$40 million for a multilateral debt trust fund (MDTF) to be managed by the World Bank. The goal of the MDTF was to enable Rwanda cover at least a third of its debt service requirements for the period 1998-2000. Among the main donors to the MDTF were Dfid (United Kingdom), Holland, and Sweden. However, funds to the MDTF, like all other donor inflows at the end of the 1990s, were much slower owing to donor concerns over the DRC crisis.

[2] Naples Terms imply that debts are reduced by 67 per cent in net value terms, in this case covering the maturities and arrears falling due between July 1997 and May 2001. The cutoff debt is end of 1994.

Table 5: Domestic debt by creditor (billions of RFw, % of total)

	1993	1994	1995	1996	1997	1998
Total domestic debt (FRw billion)	49	55	53.5	55.8	56	69.7
Central Bank (%)	58	58.8	60	62.5	59	63.6
Commercial banks	8.4	11.2	9	8.2	12.7	9.3
Non-banking sector	33.6	30	31	29.3	28.3	27

Source: Republic of Rwanda, 1999, July.

However, while policy attention has been on foreign debt, the government has incurred a substantial domestic debt as well, amounting to well over US$220 million by 1998 (see Table 5). While the bulk of the debt was owed to the Central Bank, hovering around 60 per cent of total domestic debt, a substantial share is held by the commercial banks (mainly treasury bills and development bonds) and the non-banking sector, with a large portion of the total debt comprising arrears and interest due (more on the financial sector below). Apart from the government itself, a number of Rwandan firms are heavily indebted. It has been argued that since the negative impacts of the civil war and the genocide were not confined to government activities alone, private entrepreneurs also need assistance with debt restructuring.

The Budget and the Financing Gap

Budgetary reform in a poor country can be intriguing: the 'costs' of reform, such as reduced supply of services, are 'front-loaded' while the benefits, those from the dynamic impact of a much more rational tax regime, typically take much longer to realise. Moreover, if alternative revenue sources are not found, there is often a serious threat of policy reversal.

Rwanda has a small, and after the genocide even contracting, tax base based on fuel, coffee, income taxes and indirect taxes on goods and services. According to the latest Policy Framework Paper (1999-2002), Rwanda's public finances have improved considerably since 1995 as a result of better tax and customs administration, including rationalisation of taxes. A Budget Law introduced in 1998 sought to consolidate all revenues and expenditure in the budget, and to prohibit extra-budgetary expenditure. A general value added tax (VAT) is to be introduced during 2000.

Tables 6 presents changes in government revenue since 1995. In 1995, grants amounted to 62.4 per cent of total revenue (11 per cent of GDP), falling to 33 per cent (5.1 per cent of GDP) in 1998. However, direct budget support (as distinct from the MDTF discussed earlier) has been falling, with the bulk of support coming in as capital grants. Indirect taxes amounted to 42 per cent of total revenue (including grants) in 1997, that is over 7 per cent of GDP, while taxes on external commerce amounted to 2.7 per cent of GDP in the same year (see Table 6). In 1999, the corporate tax rate was reduced from 50 to 40 per cent. This then forced the government to increase tax effort as well as supervision, so that some firms experienced an effective increase in the tax rate. The contradiction of tax reform lies in the fact that to increase tax revenue on a sustainable basis requires the expansion of the tax base. However, this can only be done if firms are taxed moderately and allowed to expand by reducing their costs of production, say via lower fuel taxes. This would, however, lower tax revenue calling either for reduced government spending, an unlikely prospect in Rwanda's circumstances, or more donor support (see also The Budget Speech for 1998 (Republic of Rwanda, 1999b)).

Table 6 : Government Revenue by Source (FRw bn, % shares, % GDP (in brackets))

	1995	1996	1997	1998
Total Revenue (FRw billion)	61.5	70.8	95.8	95.5
Total domestic revenue	37.6 (6.7)	55.6 (9.2)	60.6 (10.3)	66.7 (10.2)
Tax revenue	35.3 (6.2)	51.1 (8.5)	57.3 (9.8)	63.2 (9.6)
-Direct taxes	4.7 (0.8)	14.5 (2.4)	15.2 (2.6)	18.5 (2.8)
-Indirect taxes	30.6 (5.4)	36.6 (6.1)	42.1 (7.2)	44.7 (6.8)
Non-tax revenue	2.2 (0.4)	4.5 (0.7)	3.2 (0.6)	3.4 (0.5)
Grants	62.4 (11)	44.4 (7.4)	39.5 (6.7)	33 (5.1)
-Budget support	19.5 (3.4)	1.5 (0.1)	2.9 (0.5)	3.5 (0.6)
-Capital grants	42.9 (7.6)	42.9 (7.4)	36.5 (6.2)	29.8 (4.5)

Source: Ministere des finances et de la planification economique (1999), Republic of Rwanda (1999c)

In August 1999, the government imposed surcharges on imports to counter the revenue decline. There was a 15 per cent surcharge on imported beer, cigarettes, milk and building materials: concessions to the 'protection' lobby which has in recent years decried the impact of the liberalisation on domestic production. This seems to counter the recent reform which saw tariff rates falling from among the highest in the region to among the lowest. However, petrol, petrol products, rice and sugar, where domestic production is small or non-existent, were exempted from increased surcharges. The government also eradicated the tax on coffee imports. As an indication of the cost of tax reform, removal of the coffee tax amounted to a loss of over 2 billion FRw (about US$6 million) in revenue, which would have to be recouped from somewhere else.

With respect to government expenditure (see Table 7), it is clear that access to aid has been crucial in the maintenance of expenditure levels. However, although aid has increased considerably in recent years, dependence on foreign funding for development expenditure has a much longer history. Thus although aid now funds almost 100 per cent of capital expenditure, the government rarely managed to cover 20 per cent of development expenditure in the 1980s.

Table 7 shows that current expenditures as a percentage of GDP have remained relatively unchanged since 1995. Thus the increases in social expenditure that the government wishes to undertake are going to demand real resource transfers: that is that some sectors must receive less. The importance of this trade-off has been made most emphatically by donors with respect to military expenditure, arguing that expenditure on the army has to decline in favour of social services. The government was able to reduce the share of military expenditure in total expenditure as well as in per cent of GDP (from 5.3 in 1996 to less than 4 per cent in 1998). Expenditure on social services such as education and health, and water supply, has thus gone up as a result, but not by much. In 1998, the government set up a Genocide Fund, to which 5 per cent of the budget is allocated, to assist orphans, the handicapped and other victims through provision of education, housing, basic social services and income transfers.[3]

However, the escalation of the DRC crisis has made further military expenditure reductions, especially via retrenchment of military personnel, much more difficult to implement. During 1998, and as part of national reconciliation, ten thousand soldiers from the old army were re-admitted to the national regular army, while a new police force is being built. All these steps have of course implications for the budget (see also *Christian Science Monitor*, 1999). Thus while promising layoffs of soldiers, the

[3] In contrast, the Ministry of Justice spends almost as much on the costs of maintaining the perpetrators of the genocide in prison.

government has continued to argue that national security is a prerequisite for development. It has also argued, less convincingly due to the fungibility of budgetary resources, that military expenditure outlays are drawn purely from Rwanda's own resources and not from aid money. To ensure donors that the expenditures targets will be preserved, the government has undertaken to follow developments in the social sectors, supplying quarterly reports on realised expenditure patterns and well as the success achieved in meeting intermediate targets: that is the extent to which services are actually reaching the poor. Still to remain within the ESAF targets, in the face of falling aid inflows and revenues, the government was forced to cut back on planned expenditures in 1998 and 1999.

Table 7: Government Expenditure by item 1995-98 (FRw bn, % GDP (in brackets))

	1995	1996	1997	1998
Total Expenditure (FRw billions)	69.4	95.4	110.2	117.2
Current Expenditure (FRw billions)	42.1 (12.5)	55.9 (13)	64 (11.4)	75 (11.9)
- Military (%)	35 (4.4)	43.1 (5.3)	38.0 (4.1)	25 (3.6)
- Administrative services (%)	17.1 (2.1)	16.1 (1.7)	16.6 (1.7)	14.6 (2.3)
- Economic Services (%)	9.2 (1.1)	9.1 (1.3)	9.2 (1.2)	11.5 (1.6)
- Education (%)	16.3 (2)	16.3 (2.0)	20.5 (2.5)	18.6 (2.2)
- Health (%)	3.0 (0.4)	2.1 (0.3)	2.5 (0.3)	3.0 (0.4)
- Other Services (%)	3.4 (0.4)	1.1 (0.1)	2.4 (0.2)	8.7 (0.4)
- Debt servicing (%)	15.6 (1.9)	12.2 (1.5)	10.8 (1.2)	8.2 (1.09
Capital Expenditure (FRw billions)	27.3 (8.1)	39.5 (9.2)	46.2 (8.2)	42.2 (6.6)
- Foreign financed (%)	100	99.6	99.8	94.1

Source: Republic of Rwanda (1999c), Gouvernement du Rwanda (1998)

Financing Gap and HIPC

As shown above, aid has been the main source of external funding for Rwanda in the past 5 years. Investment by the Rwandese diaspora was initially large, but was bound to wear off as business plans were realised or as the situation was re-assessed. The other source was exports, which as seen above covered less than a quarter of imports. Initially, short-term humanitarian aid dominated because it was necessary to address the enormous human catastrophe that confronted Rwanda: provide food and clothing to displaced persons and help to bring about a return of basic services to the urban areas and the countryside. However, by its very nature this type of aid was not sustainable, it was necessary to revert to aid directed at creating capacities for long-term growth and development. In its presentation at the donor conference for Rwanda, held in London, July 1999, the IMF presented estimates of Rwanda's medium-term external financing needs for the period 1999-2002 (see Table 8).

Table 8 : Rwanda's financing needs 1999-2000, (US$ mn) (IMF estimates)

	1999	2000	2001	2002
Total external financing needs	361.9	282.5	273.3	261.6
- Paris club, IDA, AfDB, EU, etc.	162.2	74.4	57.6	34.0
- Budgetary support (including financing directed at social sector and poverty reduction (MDTF etc.))	124.1	80	180.0	150

Source: IMF (1999)

In 1999, it was estimated that the country needed a total of US$362 million in external financing, of which close to 50 per cent (US$162.2) would come from renegotiation and other operations with the Paris Club, and non-Paris Club creditors, credits and grants from the World Bank, EU, and the AfDB. But even after substantial balance of payments support, including disbursements to the MDTF, the IMF estimated that the country would still fall short of its total external financing requirements. It must be noted, however, that the estimates in Table 8 are 'supply' driven, based more on projections of what donors are willing to offer than on Rwanda's real medium-term financing needs, which are higher (see Republic of Rwanda, 1998c). In the past, donor funding has fallen short of targets, and the drawing up of contingent plans, on the part of the government, is pertinent.

The HPIC programme is seen as a possible solution to closing the external financing gap. Towards the end of 2000, Rwanda's ESAF will be three years old, qualifying the country to HIPC entry point. Under the enhanced HIPC terms discussed in Cologne in 1999, Rwanda could then embark on another 3 years of economic reform but with a 'floating completion point'. Bilaterals and the World Bank could then decide at what point during the interim to begin providing relief. The IMF is itself planning to look at an instrument that could provide relief to Rwanda during this period. The International NGO, Oxfam (1999), argues, however, that a failure of the HIPC programme is that it provides 'too little relief, too late'. It is thus advocating for HIPC relief to Rwanda already by 1999. This is because in its opinion Rwanda has been pursuing reforms at least since the introduction of an IMF 'shadow programme' in 1995, and had thus already established a three-year 'track record' and more. Experience in neighbouring Uganda shows that the help of influential countries is important in getting the country to 'completion point'.[4]

A Note on Swedish Aid

Since 1995, Swedish official interest for developments in Rwanda has increased, not least because the country subsumes Sweden's goals for international development co-operation: support for the poor, reduction of human suffering and eradication of social injustice. Sweden also provides support to Rwanda as part of its general interest in countries of the Great Lakes Region, the bulk of which receive development support from Sida, and are currently involved, directly or indirectly, in the civil war in the DRC. However, most of Swedish aid to Rwanda has been of humanitarian type, and channelled in recent years through the Red Cross, the UNHCR, UNICEF and the UNDP. More recently, Sweden has contributed to the Multilateral Debt Trust Fund. Compared to its European counterparts such as Britain and Holland, however, the amount of Swedish aid to Rwanda has so far been modest. This rather cautious approach can also be explained by Sweden's relatively low-level diplomatic presence in the country and the absence of a regularised development co-operation programme.

[4] The Ministry of Finance and Economic Planning (1999, June) in its overview of the economy has noted that the success of resource mobilisation efforts will depend very much on the good will of external partners, a realistic admission given the geo-political realities of the region.

4. Sector reforms and outcomes

In the foregoing sections, we discussed the macroeconomic aspects of Rwanda's economy, with emphasis on economic reforms. In this section we look at sector responses with a focus on agriculture, the public sector, industry and the impact of privatisation and the financial sector. The social sectors and poverty are looked at in the next section.

Agriculture

As in many other African countries, agriculture is a key sector in Rwanda. Agricultural decline had set in by the mid-1980s, reducing the nutrition status of the population and also reducing productivity (Muller, 1997). The country then became one of the most dependent on food aid in Africa. While food aid reduced the threat of famine, it was also partly responsible for blunting price signals and farmer incentives. The population displacements that took place in the 1990s further eroded production structures in agriculture. For example the destruction of livestock (up to 80 per cent of pre-1994 stocks were lost) removed a cheap source of manure, while the genocide severely reduced agricultural manpower.

The return of peace saw a rapid resumption of agricultural production. By the end of 1998, food production had risen to 4.3 million tonnes, an increase of 100 per cent over 1994. However, this was, as noted above, mainly a result of the return of peace not an increase in inputs or improved efficiency. Moreover, it can be argued that with respect to agriculture, the 'peace premium' may very well have come to an end. Henceforth, increased production will demand higher productivity via increased use of modern inputs and income incentives.

With these challenges in mind the Ministry of Agriculture (MINAGRI) has embarked on a series of ambitious schemes meant to revolutionise agriculture, relieving it of the legacy of underproduction, soil de-gradation and poor returns. In MINAGRI officials admit that, so far, the country does 'not do modern agriculture.' This is mainly for two reasons. First in the past too much emphasis was put on preserving traditional methods of production, even when they had long been superseded by developments elsewhere, notably the rapid growth of the population which had exceeded rural land availability. The government also put undue emphasis on the virtues of self-sufficiency with most rural households growing their own food. But owing to shortage of arable land, this meant that holdings were split among a multitude of uses, leaving little scope for specialisation.

Second, after the genocide the few attempts at introducing enhanced technologies, such as new varieties and better equipment, were made difficult by the poor quality of extension services. This itself was due to a general lack of agricultural specialists and extension officers, those that existed before the genocide having been killed, while others had fled the country. Thus although agriculture has seen much emphasis in recent years, with a sharp increase in the number of donor-funded projects, lack of specialists has led to poor project implementation. Similarly, there has been a serious loss of output due to pests and plant diseases, while lack of modern storage facilities also leads to large post-harvest losses. Lack of expertise has also meant that unique land endowments, such as the wetlands around the Kagera river, have not been exploited.

The new agricultural policy strategy is bent on encouraging farmers to adopt farming methods and habits which will ensure them individually the highest return on their output, while nationally ensuring food security, improved rural income generation as well as agricultural diversification. The government's evolving agricultural policy can be summarised as follows:

- Regional specialisation
- Crop diversification
- Intensive use of modern inputs via better pricing and distribution
- Introduction of high-yielding varieties as well as enhance domestic livestock
- Improve rural infrastructure and provision of services at affordable cost
- Ensure adequate supply of credit to rural areas
- Improve laws and regulations pertaining to land tenure and inheritance
- Promote research, demonstration and extension services
- Raise level of education and skills of agricultural officers

- Enhance the role of the private sector in the marketing and supply of inputs
- Promote non-agricultural economic activities in the countryside

Although Rwanda is a small country, its physical features and varying climate enable it to grow a variety of crops throughout the year. In recent years, the government has emphasised the need for regional crop specialisation, taking into account the needs and opportunities in the various agro-climatic zones of the country. The crops encouraged should, however, also have a strong poverty reduction content, with income and nutritional benefits for the farmer. These have been identified by MINAGRI as maize, sorghum, rice, beans, cassava, and potatoes. With specialisation, the country would not only be able to overcome its perennial food shortages but also to generate a surplus for export to the East and Southern African markets. However, a number of impediments are confronted by Rwandese farmers, and need to be addressed (Clay, 1996).

Fertiliser use is extremely low, estimated in the mid-1990s at 1 kg/hectare compared to 15 kg/hectare for Sub-Saharan Africa. This low intensity of fertiliser use was in the past assuaged by the availability of animal manure in almost every rural household. However, loss of animals during the civil strife and genocide reduced access from this source. Still, with little fertiliser produced in the region, the country has to depend on imports, which normally cost more than poor farmers can afford. The government thus has the difficult task of boosting fertiliser use among peasants but with little means of subsidising it.

Other serious setbacks to agriculture include the ageing stock of coffee trees as well as the low productivity of the cattle stock. In either case, there is need for the introduction of enhanced varieties. The age of coffee trees in Rwanda is about 30 years, with some trees planted already in the early 1950s. Apart from loss of human life, one of the most serious impacts of the civil war and the genocide, was the wanton slaughter of animals. The country's dairy industry was virtually wiped out over the period 1990-94. In the mid-1999, the country was producing a small fraction of total milk demand, estimated at about 2 million litres per day. The milk production level for the domestic animals is very low, while the quantity of meat is small as well. In recent years, the Rwanda Development Bank has embarked on the importation of heifers from Europe, marking the beginning of the rehabilitation of the dairy industry. Still, there is some doubt as to whether poor peasants will be among the first to benefit.

During the era of market reforms, a number of serious impediments to rural development in general and agricultural development, in particular, have been identified: poor access to credit, poor nature of the infrastructure, and inadequate provision of rural services.[5] While poor policies are mainly to blame for the poor flow of services, the structure of rural land holdings has also been a problem. The absence of laws and regulations pertaining to land tenure and inheritance has implied lack of a market for land. Since most rural land holdings are inherited, reforms thus also relate to the difficult problem of reversing age-old cultural practices, including poor enforcement of female rights of inheritance.

The next set of constraints relates to raising the quality of human resources within agriculture. The agriculture hitherto practised in the country made few demands on the research capacities of the specialised institutions since traditional knowledge seemed to be sufficient. However, in order to overcome the constraints that are holding back productivity, it is necessary for the government to improve agricultural research, and also to be able to disseminate results via demonstration farms and by expanding extension services. MINAGRI is now encouraging the development of 'model farms', run by individual 'progressive' farmers, which can then be supported directly by the government with a view to demonstrating the benefits of adopting modern production methods. Still, if peasants lack incentives to engage in market production, demonstration farms might do little to improve their output. Part of the research agenda must include how to recapture the peasant, after many years of neglect. Thus besides, enhancing rural security, among the objectives of villagisation, also called the 'umudugudu policy', is to establish a critical mass for the introduction of modern production techniques such as mechanised farming, while supplying the required extension and training services to as many farmers as possible.[6]

[5] Ironically, as a result of the massive inflow of humanitarian aid to Rwanda, ferried across the country with the help of heavy trucks, many roads were badly damaged and are in urgent need of repair. Handling and storage facilities for agricultural produce are poor or not available at all.
[6] Commentators have noted (see *The Economist*, 23 January, 1999) that historical precedent would not be on the side of state-led villagisation, irrespective of its *raison d'être*.

In the past, agricultural policy emphasised the importance of government owned companies in the marketing of output and the provision of inputs such as fertiliser. With economic liberalisation, private sector participation is now encouraged, especially since many parastatals are now being sold off to the private sector. The development of non-agricultural activities in the countryside, notably in the provision of goods and services to peasants, is also important to encourage. For peasants to prosper, it is important that 'incentive goods' are provided in their proximity.

Public sector

Within the public sector, reforms have focused on the reorganisation and strengthening of the civil service, by improving incentives and undertaking a functional reorganisation, which involves a close monitoring and control of recruitment and the payroll. An evaluation from 1995 showed that more than 75 per cent of the public sector workers had not completed secondary school, while only 3.6 per cent had university diplomas or degrees (Gouvernement du Rwanda, 1998). From early 1999, the government introduced a new pay structure, along with a differentiated wage increase. All fringe benefits were monetised, while health insurance was introduced for all civil servants. The goal being to rationalise the functions of the civil service thus enhancing its ability to deliver services to the population.

While many public institutions were in need of rehabilitation and many policies needed to be updated, a central concern in recent years has been the relatively poor capacity of the public sector to absorb investment funds, and the poor performance of public projects. Ministries clamour for new projects but have had little planning and implementation capacity. Generally, lack of local capacity has necessitated undue involvement on the donor side in project planning and implementation.[7] With respect to absorption, the public investment programme (PIP) was only able to meet 50 per cent of its investment targets for both 1997 and 1998. The Ministry of Finance and Economic Planning then set up the Central Projects and External Finance Bureau (CEPEX) as well as project execution units in all ministries. These were already

[7] The World Bank has been able to see its projects through because it has an adequate project supervision machinery. However, projects from bilaterals, and some multilaterals such as the AfDB, and other institutions without country representation and the follow-up machinery required have met with a number of difficulties.

operative in 1999. A number of consultants have also been hired to help improve the government's capacity for project implementation and to undertake capacity building.

In its attempts to decentralise power and bring decision making closer to the people, the government undertook local elections in March 1999, at the level of sectors and cells, the latter comprising ten households. The government felt compelled to do this as a way of returning legitimacy to the process of governing, especially since earlier officials, not elected by the people, had been implicated in the genocide. The administrative and political reforms undertaken at the local level were the subject of extensive debate and thus can be said to have support among the broader population. The ultimate goal is to make the commune the motor of development.

Industrial Sector and Privatisation

Rwandan industry was traditionally of the import-substitution type, coupled with strong government participation. Unlike agriculture, which depended on local resources and thus rebounded quickly after the civil war and the genocide, industrial activities depend heavily on imported intermediates and delays in their arrival have disrupted production. This has meant that manufacturing operates at low capacities, while high levels of indebtedness and a lack of long term credit have prevented new investments. Especially private investment is still low, although official figures seem to underestimate the amount of private investment currently taking place in the country, especially that directed to real estate in urban areas.

In spite of its rapid rehabilitation, Rwandese manufacturing still has a serious problem of lack of competitiveness. This is partly a legacy of the import-substitution era and high tariffs, which enabled government-owned companies to operate without much thought to efficiency or competition from imports. Firms have more recently been faced with a lack of experienced managers, while workers are poorly trained and lack skills. Rwandan industry used to export to eastern DRC and to neighbouring countries, but regional markets have been seriously disrupted by the crisis.

Macroeconomic reforms have helped to streamline the functions of the government sector and to reduce the burden of bureaucratic inefficiency on the private sector. There is, however, need for the development of a 'real' corporate sector that abides by the rules, and that in turn is responsive to market signals. Experience from other African countries shows that this can be difficult to achieve in the early stages of market development, since in a small market business tends to be personalised, which disables market signals.[8] Still, the corporate sector feels that taxes are too high and that the government should provide some protection from imports, especially given the very special circumstances under which Rwandan firms are operating. However, should the government concede, as the recent increase in import surcharges would suggest, its other wish of converting local firms into exporters of finished products will have to be put on hold.

With respect to privatisation, Rwanda purports to have learnt lessons from its neighbours and thus has developed a well-planned programme. The Privatisation and Public Investment Law was passed by Parliament in 1996, with a subsequent Presidential Decree creating a Privatisation Commission mandated to undertake a divestiture programme. The programme was embarked on in October 1997. As in other countries, the companies to be divested included those for immediate privatisation, those for liquidation and those in which the government would preserve a full or partial stake. An important approach has been to prepare legal and regulatory frameworks way ahead of privatisation of the major utilities and important industries and sectors. This is most notable in the case of electricity, telecommunications and in paving way for private sector participation in the energy sector. Of a total of 55 enterprises, the government had privatised 22 by July 1999, while another 15 were up for sale. In the tea sector, plantations and firms running them have been privatised, while in coffee, factories have been sold and the government is encouraging industry-based interests to take over the Coffee Board and its regulation of the industry.

As in many other African countries, privatisation has caused domestic anxiety, especially with respect to asset ownership, which some groups feel has fallen

[8] In Latin America this was christened 'crony capitalism'.

disproportionately into the hands of foreign investors.[9] Many companies where the government had acquired shares have been returned fully to their owners. However, the growth of the private sector is not driven by privatisation alone. Many returnees have set up modest businesses, while the confidence of those who remained is returning. Given a dynamic environment, the nature of Rwanda's private sector will in the medium to long-run be determined not so much by today's privatisation exercise, but by the extent to which it encourages market development via the creation of new firms and expansion of investment.

Financial sector

The development of a market economy depends on the healthy growth of the financial sector. In Rwanda, banks still suffer from the 'overhang' of the genocide, many businesses were disrupted and their clients and managers killed. However, like in other African countries, the financial sector is also constrained by an accumulation of non-performing assets, as newly created businesses have become distressed, while individuals have also borrowed on the basis of their connections. Owing to a lax attitude to repayment and the difficulty of bringing economic crimes to foreclosure in the currently overburdened judiciary system, many borrowers have defaulted with the knowledge that the implications will be limited. The government has estimated that up to 30 per cent of the assets of the commercial banks are either non-performing or highly risky. The IMF has also advocated for substantial provisioning across the board.

The poor consolidation of the banks, together with the low level of savings (60 per cent of the total savings are short-term) in the economy have tended to make credit scarce. Still, by 1997, total bank credit had increased almost fourfold in comparison to 1994 (Table 9). However, on the whole the shares of the various sectors in total credit have changed in only one significant aspect. The share of manufacturing in the total has been falling while that of commerce (distribution and trade) has been rising. It is noteworthy that in spite of the policy emphasis on agriculture, and the need to increase credit to farmers, the sector's share is, at only a tenth of a percent in the first half of 1999, insignificant. Left to them, banks will not want to finance agriculture, given the risky

[9] Among African countries, Ugandan groups as well as South Africans have bought strategic stakes

production environment and the still unresolved problems of land ownership make land poor collateral. Construction and real estate sectors show increases in the share of total credit, which is also reflected in the private structures that one sees around Kigali.

Table 9: Rwanda: Commercial Bank Credit by sector, 1994-June 1999, (FRw billion, %)

	1994	1997	June 1999
Total bank credit (FRw billion)	12.1	45.9	67.29
Agriculture (%)	0.5	0.3	0.1
Manufacturing (%)	30	20	13
Construction (%)	15.2	10.7	13.5
Real Estate (%)	7.2	8.4	11.7
Distribution and Tourism (%)	31.8	47	45.6
Transport and Communication (%)	5.2	4.8	5.3
Other	11.0	8.7	11

Source: Banque Nationale du Rwanda (1999b)

In reforming the financial sector, considerable powers have been given to the Central Bank, with its independence enshrined in a 1997 Statute. Under the ESAF programme, the government has mostly kept its budget deficit within agreed limits, partly thanks to aid money. Thus the Central Bank's independence, in the sense of resisting public sector demands for deficit financing, yet are to be put to the test. As elsewhere in the economy the Central Bank's human resources are inadequate (Banque Nationale du Rwanda, 1999a). It has not been able to exercise its full powers of supervision of the commercial banks and financial institutions. Moreover, the Central Bank has in the past had few instruments for the conduct of monetary policy. More recently, it has embarked on 'market operations' selling and redeeming T-bills to the public and public enterprises and intervening in the foreign exchange market to stabilise the franc, but without defending any a priori set level of the exchange rate. Via an ambitious recruitment programme, the Bank has raised its staff above 400 from around 120 following the genocide.

ranging from hotels to telecommunications.

5. Poverty reduction and the provision of social services

Poverty in Rwanda is a chronic structural problem without easy solutions. In 1993 it was estimated that up to 53 per cent of the population was poor (compared to 40 per cent in 1985). We noted above that much of this poverty was to blame on the inadequate performance of the agricultural sector, which reduced the incomes of the peasants while also lowering their nutritional status and that of their families. With poor nutrition came weaker resistance to disease, which again was reflected in inability to work their farms. Peasants became lethargic and passive and thus not receptive to new farming technologies and other policy interventions.

The genocide aggravated this generally downward trend in social welfare. Up to 10 per cent of the population was lost during the massacre, while poverty engulfed the country, with 70 per cent of the population considered poor by 1996 (World Bank, 1998b). Moreover, poverty became common in urban areas as well. While poverty fell somewhat as peace returned, the country remains one of Africa's poorest, ranked 175 on the UNDP's Human Development Index, that is with only Sierra-Leone behind it. It is also estimated that of the population aged over 12 years, 10 per cent are carriers of the HIV virus. Life expectancy has fallen rapidly in recent years, as a result of AIDS, now estimated at only 39 years (many countries in the region have seen their life expectancies fall to similar levels in the face of AIDS) (see for example Dfid, 1998). As an indicator of the long period of declining living standards, 42 per cent of the children under 5 showed signs of long-term malnutrition (stunting).

The effects of the genocide itself on poverty have been multifaceted. The scale of the humanitarian tragedy meant that the social safety nets were overwhelmed, with few relatives able to take on extra burdens. The social disruptions have also led to the emergence of complex cases of need. Many households lost their members, were maimed and lost their productive assets such as land and cattle. A number of them are now headed by widows and orphans and are extremely vulnerable to disease, violence and malnutrition.[10] Moreover, the disruptions have also led to involuntary separation of

[10] The UNICEF (1997) has argued that children and women's rights were grossly violated during the genocide and 'long-term efforts' will be required by the government and its partners to redress the social dislocations these violations have engendered.

children from their parents. In the case of many widows, it has been difficult to lay claim to the late husband's property (mainly land). This was not entirely for lack of property rights legislation but due to its poor enforcement, within a judicial system overloaded by other serious cases. The Genocide Fund set up by the government to address these issues is a laudable attempt, but with its current funding can only scratch the surface.

The donor community has responded positively to Rwanda's social needs, declaring the country a 'special case', which is deserving of extra assistance. However, it is also a country that has a military presence in the DRC, which it sees as necessary to prevent a recurrence of the massacres of the early 1990s. This argument notwithstanding, the DRC crisis has tended to slow down the speed of disbursement of the funds promised to Rwanda at the various international forums.

There has also been concern that while Rwanda's case calls for compassion, lack of well-conceived strategies for poverty eradication might lead to failure to address the issues of rural deprivation and poor access to services (see for example UNDP 1999). At the Stockholm meeting, held in 1998, and where the 'special case' approach was crystallised, donors urged the government to prioritise the social sector. A subsequent social sector expenditure revenue by the government (Ministry of Finance and Economic Planning, 1999 a&b) not only underlined the need for increases in social spending (especially on education and health, but also water and access roads) but also that of increasing the government's ability to monitor the impact of its interventions. This could be done via intermediate indicators. In health these could be number of consultants hired, doctors, nurses, fully equipped clinics, and average distance to nearest health centre. In the case of education they would include the number of teachers, enrolment rates, number of books per pupil, completion rates, and rate of graduation to next level. The longer-term targets would then include, in health, such issues as the lowering of morbidity (raising life expectancy) and in education the raising of literacy rates (see also Republic of Rwanda 1998b).

The government has made poverty eradication the *raison d'être* of its economic policy, while the support of donors is contingent on seeing it applied. The success of poverty eradication will depend on the resources that policymakers will be able to commit.

However, the size of Rwanda's poverty affliction is too big for the country to address alone, especially in light of recent history. By devising a medium term expenditure framework (MTEF), comprising a comprehensive and transparent mechanism for the allocation of both domestic and donor resources, government hopes to establish a basis for sustainable poverty reduction and development, supported by the donor community.

Reducing Rwanda's poverty from around 70 per cent of the population under the poverty line, recorded at the end of the last decade, will not only demand high growth, over 7 percent yearly well in the next two decades, but also policies geared towards human development, disease eradication and employment. Notably efforts will be geared towards raising agricultural productivity, not least by developing a sustainable input distribution system, improvement of livestock and fisheries, and undertaking land reform.

Social services, notably education, health services, water and sanitation, suffer from a legacy of underfunding, which in turn inhibits the speed with which the government can embark on the expansion of human capacities, crucial for fighting poverty. In its policy statements (see Republic of Rwanda, 1999c) the government has emphasised a people focused development strategy – allowing effective participation of all groups in the population. However, social sector expenditure, as shown in Table 7 above, is still modest (less than 3 per cent of GDP), competing poorly with more urgent outlays elsewhere in the economy. In the short to medium term, aid has been a key offsetting factor, helping return basic services on stream. However, with the end of the emergency phase, more innovative strategies will be needed to help direct resources to the social sectors, especially in light of the government's ambitious plans to improve access to primary education as well as primary health care.

In its 20-year development plan, presented at the end of the 1990s, the government hoped that the policies it is currently pursuing shall raise per capita income from US$ 250 in 1999 to US$ 5000 by 2020. By then, the number of people below the poverty line will only amount to 20 per cent of the total population estimated to be 16 million by then.

6. Medium to long-term issues

In July 1999, the transition government extended its mandate for another four years in order to complete its task of national reconciliation. The extension coincided with the government's goal, and that of the donor community, to transcend the era of humanitarian interventions and look further ahead. There was a feeling among government ministries as well as donor circles that while the country had benefited greatly from the 'peace dividend' it had become necessary to emphasise policies that will ensure long-term growth. These would have to be based increasingly on the expansion of the country's own resources via private sector growth and human resource development.

The government has emphasised the following issues:

- Preservation of macroeconomic stability
- Creation of a domestic environment that is supportive of private sector expansion (and external competitiveness)
- Improve institutional and administrative capacities
- Prioritise government expenditure towards human resource development and skills formation
- Emphasise agricultural development and poverty reduction
- Consolidate the progress made in national reintegration, reconciliation, governance and transparency.

Even the main UN agencies such as the UNDP (1999), UNICEF and WFP (1999), responsible for the bulk of the emergency assistance, are switching to a more long-term engagement, which involves the scaling down of humanitarian type assistance in favour of a broader development-oriented strategy. Recently, the UNDP has, for example, helped rehabilitate the country's national statistics, but perhaps more importantly it is helping Rwandese officials acquire better negotiation skills via capacity building in key ministries. In January 1998, the UNICEF switched to a programme of operations as opposed to annual programmes, beginning with a 'bridging programme' of 3 years. The goal is to co-ordinate activities closely with the government. The first 'strategy' meeting with the Ministry of Finance was being planned for September 1999. Likewise, the UNHCR has been helping with the construction of the new villages, seeing its role in a large perspective than merely that of refugee relief.

Rwanda has in the past few years clearly expressed its desire to join the East African Community, seeing it as a natural extension of its economic, security and political interests. The view of the other countries, Tanzania, Uganda and Kenya, have been largely accommodating. However, the political and security crisis in the Congo and the Great Lakes seems to have removed regional integration from the top of the agenda. Still, Rwanda already is largely integrated in the East African region, not least owing to the freer movement of people between countries, commonality of local languages and greater use of English and Swahili. The countries are also joint members of the Community for Eastern and Southern African States (COMESA), and have agreed, at least in principle to undertake far-reaching tariff reductions.

Still, while there is much that unites these countries, economic policies might be difficult to co-ordinate, at least as long as governments undertake widely varying fiscal policies. As landlocked countries, Uganda and Rwanda depend on road transport, and thus on the quality of services in transit countries, Kenya and Tanzania. For fiscal reasons the former impose higher fuel taxes than their neighbours. This has led to higher domestic costs for fuel, higher production costs and ultimately smuggling of fuel and other goods. It will thus be important to co-ordinate fiscal policies as well as those directed to trade and industry.

Finally, while increased use of English is seen as enhancing Rwanda's international contacts and information flows, there is some benefit in the country's retention of some of its francophone legacy. It will stand it in good stead when peace returns to the DRC and the Great Lakes as a whole. Rwanda could very well become the cosmopolitan crossroads of the region.

7. Concluding Remarks

Some aspects of Rwanda's recovery and post-genocide experience were predictable, at least in retrospect: agriculture was the first to recover, since what was needed most there was a return to more peaceful conditions. Industrial recovery took longer because the constraints on it were more binding: lack of spares, imported intermediates, suitably qualified workers, and working capital. Shortage of the latter being caused by the difficult credit situation of the commercial banks, itself partly a legacy of the genocide and the domestic debt overhang. It was also foreseeable that initially economic reforms would be difficult to implement for lack of human resources. Another relatively easy prediction was that as Rwanda went beyond the need for humanitarian assistance, the international donor community would become more assertive in its demands for change. But also predictable, at least from the experience of neighbouring Uganda, the defeated groups were bound to regroup and that their presence was bound to cause considerable domestic insecurity. This has meant that as long as the threat persists, security considerations will take precedence over whatever promises are made to donors regarding military expenditure.

Less predictably, the transition government managed to return the country to macroeconomic stability quite rapidly, even as it was confronted with serious security and financial challenges. While foreign aid has played a crucial role in returning the economy to normality, it can be noted that many countries have received similar assistance without making much progress. It has taken policymakers much work and discipline to get the country where it is today, five years after the genocide. Still, as has been demonstrated in the recent past, aid can never be entirely free of conditionality, it can also be cut off abruptly and in any case eventually comes to an end. Rwanda thus needs to plan a long-term strategy for reduction of its dependence on aid. This cannot be done quickly, however, and demands that the aid currently flowing in be used imaginatively to enhance domestic capacities for exporting, improving market competitiveness and for institutional building, notably in the area of regulation and in strenghtening the central functions of the public sector.

Besides being an economically cataclysmic event, the genocide was also a social, political and moral 'black hole'. It led to an unprecedented loss of life, destruction of assets as well as severe disruption of rural and urban livelihoods. Thus few can say with certainty what the long-term implications of the tragedy are going to be. In efforts to ensure sustainable development, the government has emphasised national integration and reconciliation. However, these are premised on sustainable peace. It is only under more peaceful conditions that the government will be able to recreate the economic and political environment necessary to raise the incomes of the poor by boosting agricultural productivity and improving their access to social services.

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