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IMF Programs and Health Spending: Case Study of Rwanda

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Abstract

This case study examines the interaction between IMF program design and health spending in Rwanda. The aim is to investigate a number of potential criticisms of IMF-supported programs, most notably whether the macroeconomic frameworks underlying the programs unduly constrain the policy space within which feasible options concerning the level and composition of expenditures should be left to domestic political processes to decide. The focus of the study is on the programs negotiated under the Poverty Reduction and Growth Facility (PRGF) since 2002. We focus on these recent programs in order to examine how well the IMF is adapting to a situation in which the main macroeconomic policy challenge is not to address short-term macroeconomic instability but to make good choices on how to utilize the potential for greater fiscal space and how these macro choices have interacted with a scaling-up of health spending, including its long-term fiscal consequences. We conclude with lessons for the IMF, the Government of Rwanda, and donors.

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Section I gives an overview of economic and health outcomes in Rwanda; Section II assesses the recent IMF-supported programs; and Section III discusses the health sector strategy, its links with budgetary processes and priority-setting, and the role of donors. The concluding section presents a number of lessons.

I. Overview of Key Economic Developments and Health Outcomes

Rwanda is a densely populated country, with a population of about 8 ½ million and per capita income of about $230 in 2005. The economy is heavily based on agriculture, which provides about 40 percent of GDP, employs some 90 percent of the population, and faces heavy land pressures and considerable challenges to raise productivity. The 1994 genocide and civil war that preceded it had a devastating effect on the country and the economy, with close to one million people killed and almost half the population displaced at some point. Large numbers of professionals, including many health service workers, were killed or fled. Income per capita collapsed to about half its previous level and by the end of the genocide an estimated 78 percent of the population was below the poverty line compared with about 50 percent earlier in the decade. Subsequent growth was quite strong—averaging 9 percent a year during 1996-2001—as the economy began to recover from the effects of the war and genocide (Table 1). The recovery was slower in rural areas. More than 3 million people returned to Rwanda by 2000, creating pressures on land, housing, and other assets. Poverty is still widespread: in 2005/06, 56.9 percent of the population was below the poverty line (down from 60.3 percent in 2000/01) and 36.9 percent of the population was living in extreme poverty (41.3 percent in 2000/01).[1]
In 1998 the Government launched an process of national consultation over long-term development objectives. The resulting strategy, known as “Vision 2020”, outlines a long-term development path with ambitious goals to transform Rwanda into a middle-income country (i.e., with per capita income of about $900 per year) by 2020, which would require sustained average annual growth of about 7 percent. The Poverty Reduction Strategy Paper (PRSP), written in parallel with the Vision 2020, is described as the medium-term instrument to begin making this vision operational. The PRSP, completed in 2002, focused on six strategic areas that reflected the pillars of Vision 2020: rural development, private sector development, human development, infrastructure, governance, and capacity building. A second generation PRS—the Economic Development and Poverty Reduction Strategy (EDPRS) is now under preparation and is expected to be completed in the first half of 2007.

Table 1. Rwanda Key Macroeconomics Indicators, 1997-2005									
	1997	1998	1999	2000	2001	2002	2003	2004	2005
Inflation (percent)	16.6	-6.0	2.1	5.8	-0.2	6.2	7.7	10.2	5.6
Real GDP growth (percent)	13.8	8.9	7.6	6.0	6.7	9.4	0.9	4.0	6
Fiscal (in percent of GDP)									
Grants	8.0	7.4	9.1	11.3	10.0	9.9	11.4	15.2	16.3
Revenues	10.4	10.6	9.9	9.7	11.4	12.2	13.5	13.9	15.1
Total expenditures	19.6	18.9	19.6	18.7	21.0	21.2	23.9	26.1	28.5
Overall balance, before grants	-9.2	-8.3	-9.7	-8.9	-9.5	-8.9	-10.3	-12.1	-13.4
Overall balance, after grants	-2.5	-3.0	-4.0	0.7	-1.3	-1.7	-2.3	-0.2	0.7
External									
Total net aid flows (US$ million)	312	381	329	320	342	266	276	417	492
External current account balance, before grants (% of GDP)	-17.5	-17.0	-16.7	-16.3	-15.9	-16.6	-19.2	-18.2	-19.4
Gross external reserves (in months of imports of goods and services)	4.0	4.6	4.7	5.4	6.0	6.3	5.0	5.7	6.2

Source: IMF documents

Rwanda is heavily aid dependent. Aid flows peaked in 1994-95 at around $700 million a year in the immediate aftermath of the genocide but then averaged around $340 million a year (about $40 per head until the last few years, when it has begun to increase again).[2] In recent years, aid has financed about half of Rwanda's total budget, not including substantial off-budget aid (particularly in the health sector).

Despite some significant recent improvements, the health status of the population is still worse than in the early 1990s. The rates of infant and under-5 mortality as well as maternal mortality are all high (Table 2). Malaria, acute respiratory infections, diarrhea diseases, and malnutrition are the major causes of death. Malaria accounts for at least 40 percent. HIV/AIDS prevalence in the adult population is now estimated to be about 3 percent, significantly lower than earlier estimates.

Table 2. Millennium Development Goals (Rwanda)																	
	1990	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
Goal 1: Eradicate extreme poverty and hunger																	
Poverty headcount ratio at national poverty line (% of population)	-	-	-	51.2	-	-	78	-	-	-	60.3	-	-	-	-	56.9	-
Prevalence of undernourishment (% of population)	-	43.0	-	-	-	-	51.0	-	-	-	-	-	36.0	-	-	-	-
Goal 4: Reduce child mortality																	
Immunization, measles (% of children ages 12-23 months)	83	89	82	74	25	84	76	66	78	78	74	69	69	90	84	86 -	-
Mortality rate, infant (per 1,000 live births)	103	-	-	-	-	124	-	-	-	-	118	-	-	-	-	86	-
Mortality rate, under-5 (per 1,000)	173	-	-	-	-	209	-	-	-	-	203	-	-	-	-	152	-
Goal 5: Improve maternal health																	
Births attended by skilled health staff (% of total)	-	-	-	-	-	-	-	-	-	-	31.3	-	-	-	-	38.6	-
Maternal mortality ratio (modeled estimate, per 100,000 live births)	1300	-	-	-	-	2300	-	-	-	-	1071	-	-	-	-	750	-
Goal 6: Combat HIV/AIDS, malaria, and other diseases																	
Children orphaned by HIV/AIDS (thousands)	-	-	-	-	-	-	-	-	-	-	-	160	-	220	-	210	-
Children 1 year old immunized against measles, percentage	83	89	82	74	25	84	76	66	78	78	74	69	69	90	84	-	-
Prevalence of HIV, total (% of population ages 15-49)	-	-	-	-	-	-	-	-	-	-	-	5.1	-	3.8	-	3.1	-
Incidence of tuberculosis (per 100,000 people)	252	-	-	-	-	-	-	-	-	-	555	601	625	648	660	-	-
Tuberculosis cases detected under DOTS (%)	-	-	-	-	-	33.7	33.2	39.1	51.8	43.6	33.0	26.7	30.3	33.9	29.4	-	-
Tuberculosis death rate per 100,000 population	40.1	-	-	-	-	-	-	-	-	-	86.6	93.1	96.4	100.0	101.8	-	-
Other																	
Life expectancy at birth, total (years)	31	-	24	-	-	32	-	37	-	-	41	-	44	44	44		

***Source: UN Millennium Development Indicators ;World Development Indicators, World Bank ; DHS 2005; Household Living Conditions Survey 2005/6; and Health Sector Strategic Plan, 2005-2009.**

II. The IMF-Supported Programs [3]

Since the focus of this case study is on recent programs, it is worth recalling the "key features" that were meant to distinguish programs under the PRGF, introduced in 1999, from the earlier ESAF: (i) broad participation and greater country ownership; (ii) embedding the program in a broader strategy for growth and poverty reduction; (iii) government budgets that are more pro-poor and pro-growth; (iv) appropriate flexibility in fiscal targets; (v) more selective structural conditionality; (vi) emphasis on measures to improve public resource management and accountability; and (vii) social impact analysis of major macroeconomic adjustment and structural reforms.

In practice, of course ownership is hard to define, let alone measure. The content of programs is the outcome of a negotiation process in which different domestic stakeholders—even within the Government—are likely to have different views on priorities and the appropriate balancing of risks (e.g., between macroeconomic stability and other objectives or between social objectives such as those covered by the MDGs and narrower objectives of economic growth). So even if some stakeholders are dissatisfied with the choices that are made, this does not necessarily mean that the IMF has acted inappropriately. The approach we take here, therefore, is to examine whether or not the IMF unduly narrowed the policy space available to the authorities (especially with regard to government budgets), either by a) not considering some feasible policy options or b) ruling out such options on the basis of insufficient evidence, and so to investigate how much fiscal flexibility programs allowed in practice.

In this context, as well as being one of the earlier PRGFs, the debate on Rwanda's macroeconomic strategy that took place is of particular interest. The debate was at its most intensive around the programs in 2002 and early 2003, and resumed again in 2004. Previous adjustment efforts, supported by programs under the PRGF and earlier ESAF, had been quite successful. Growth had been strong; inflation had already been reduced to low levels (from about 50 percent in 1995 to an average of only 2½ percent during 1999-2001); and external reserves rebuilt to a quite high 6 months of imports (Table 1). But exports remained low with merchandise exports fluctuating in the range of 4-6 percent of GDP, one of the lowest ratios in the world. The export base was also narrow, and subject to considerable fluctuations in the prices of its main exports (coffee, tea, and coltan—a mineral used in the electronics industry). As a result, forward-looking debt-export indicators tended to signal potential debt sustainability problems. This was the case even after taking account of the expected impact of debt relief under the enhanced HIPC Initiative.

The Government's economic and social priorities, reflected in the PRSP that was then under preparation, called for substantial increases in spending, particularly on: labor-intensive public works, agricultural extension, credit, health (particularly support to drug prices and insurance mutuals), road maintenance and rehabilitation, education (particularly textbooks for primary education), and shelter provision. The Government initially, around 2002, took the view that a widening of the fiscal deficit—financed in large part by higher borrowing on concessional terms—was justified in light of these spending needs. The IMF disagreed, arguing that unless steps were taken to strengthen the domestic resource base, the associated sharp increase in the deficit would pose significant threats to macroeconomic stability and risked a substantial deterioration in debt sustainability. As a result, the IMF effectively rejected the three PRSP costing scenarios developed by the government, and insisted that a more constrained macroeconomic framework be annexed to the PRSP document. [4] The impasse led to an interruption of arrangements with the IMF and a lapse in interim debt relief under the Enhanced HIPC Initiative.[5] Eventually, agreement on a new PRGF arrangement was reached in July 2002. While the macroeconomic framework underlying the new arrangement was a mutually negotiated one and was "owned" by the authorities at least in the narrow sense that they had committed themselves on paper to implement it, the IMF view on the appropriate macroeconomic framework had largely prevailed. Interviews with Rwandan officials suggest that the desire to move ahead with debt relief and to unlock some other donor financing that was in practice linked to the pre-condition of an IMF program being in place. This 'gatekeeper' function was the main incentive to reach agreement; financing from the IMF itself was a minor concern.[6]

The Rwandan government and some donors (notably the UK) wished to explore further the policy options for financing larger anti-poverty expenditures and respond to the IMF's rejection of the PRSP costing scenarios.[7] The vehicle used for this exploration was a Poverty and Social Impact Assessment (PSIA) led by an external consultants with a team that included two MINECOFIN officials.[8] The analysis produced went well beyond the assessment of a particular set of policies and attempted to assess the rationale of the overall macroeconomic framework and the impact of two alternative scenarios for increased expenditures drawn from Rwanda's PRSP (See Mackinnon et al. 2003). From the outset of the PSIA process, there was significant government engagement, with ongoing interest at the highest levels with Minister Kaberuka, as well as the staff on the PSIA team. All Government officials interviewed saw the PSIA as a useful process and document. A rushed first draft of the PSIA was presented to the Development Partners' Meeting in October 2002 and around the same time to IMF Staff in Washington.

The response of the IMF to the PSIA (at least as received by Government) was rapid and strongly negative. The Fund criticised the macroeconomic model underlying the PSIA, arguing that this was not an appropriate subject for a PSIA, and that the analysis in the PSIA was technically flawed and understated the risks to sustainability. Given the strength of the IMF's response and the need to agree a PRGF program and debt relief, the Government and key donors backed off from the PSIA rather than pursuing it. Government and the key donors also lacked the technical expertise to defend the PSIA from the IMF's criticisms. Several interviewees lamented MINECOFIN's failure to support the document, arguing that it should have been formally submitted to the IMF and formed the basis for further discussions, rather than being effectively withdrawn.

As a result of this chain of events, by the time the PSIA was finalized in mid-2003, government and donors had effectively abandoned it. Although the PSIA featured on the agenda for the November 2003 Fund mission, there was no discussion of the potential tradeoffs involved in alternative strategies but a reiteration of the Fund's technical critiques. Formal IMF reports made little or no reference to the PSIA and options for alternative fiscal strategies. They confined themselves to an exposition of the framework that was finally negotiated, which was largely unchanged from the original program.

Nevertheless, the debate over the scope for additional expenditures and financing without posing unacceptable risks to longer-term sustainability remained a central policy issue throughout the

PRGF arrangement. For example, in 2004 the Rwandan authorities again argued that the benefits that would be derived from scaled-up expenditures would exceed the cost; if additional external grant commitments were not forthcoming, they viewed an increase in borrowing on concessional terms as a viable option. The IMF staff disagreed, arguing that projections of debt indicators called for tight limits on new external borrowing until the potential for export and productivity growth had been established.[9] However, as will be discussed further below, the program was eventually adapted to accommodate substantially higher grant-financed expenditures.[10]

In the event, macroeconomic performance under the program was reasonably good, although growth fell short of program projections as the catch-up effects of the recovery from the war and genocide tapered off (Tables 1 and 3). Inflation was higher than projected but remained in single digits. The Government, by and large, implemented macroeconomic policies along the lines of the programs, apart from temporary fiscal slippages, particularly in the second half of 2003, which caused delays in completing program reviews. Grants as well as domestic revenues were higher than originally projected, allowing an expansion of expenditures especially from 2004 onwards. The PRGF arrangement was eventually extended through June 2006.[11] A new 3-year PRGF arrangement, covering 2006-2009 was then agreed and also involved minimal IMF financing.[12] Rwanda eventually reached the completion point under the enhanced HIPC Initiative in April 2005 and also qualified for further debt relief under the Multilateral Debt Relief Initiative (MDRI) in January 2006.

This experience raises four sets of questions, which we will discuss in turn:

- Did the IMF have a good analytical and factual basis for the position it took on the macroeconomic framework?
- How was priority spending, especially for the health sector, treated in the programs?
- How did the program design handle uncertainty about aid flows? In particular, what did the design imply for potential tradeoffs between risks to macroeconomic stability and the costs of disrupting expenditures in the event of unanticipated shocks to aid?
- Was sufficient sector-level information on expenditures and their likely impact available to make adequate macroeconomic assessments and was available information used effectively? Was the process of negotiation and policy debate (including the role of the PSIA) useful in exploring alternative options and tradeoffs? If not, how could the process be improved?

a. The Macroeconomic strategy underlying the programs

The broad economic strategy underlying the IMF-supported programs was that set out in the Government's Poverty Reduction Strategy Paper (PRSP), completed in 2002. Sustaining strong economic growth was seen as the key to poverty reduction and, with 80 percent of the population living in rural areas, agriculture was the key focus for achieving productivity increases. The strategy to achieve sustained growth included a strengthening framework for private sector activity—through institutional reform and maintaining macroeconomic stability; and addressing sector-specific bottlenecks in agriculture. Policies to encourage export promotion, in light of the low and vulnerable starting base, were given increasing emphasis over time and were pushed strongly by the IMF. Given Rwanda's low savings rate, a strengthened domestic revenue effort was necessary, including to help prepare for eventual reduction in donor funding. However, foreign savings were expected to remain critical over medium term to meet these development and social objectives. Nevertheless, Rwanda's forward-looking debt profile was judged by the IMF to be so precarious, even after the various rounds of debt relief, as to require that such financing be largely by grants.

The macroeconomic framework underlying the original program of the 2002-2004 PRGF contained the following key elements (see Table 3 and Appendix Table 1):

- Conservative assumptions about aid flows. External grants were assumed to remain broadly flat in dollar terms over the 3-year period (at around $240 million per year). This was actually slightly below the average of $260 million received during 1995-2001. Loans from donors were expected to decline significantly over the program period. Indeed, the program was designed to bring about this decline since it ruled out any borrowing (except from the IMF itself) that did not have a grant element of at least 50 percent.[13] Therefore, overall net aid flows were projected to decline over the period, even after taking account of expected debt relief (Chart 1).
- A reduction in various measures of the fiscal deficit by about 1-½ percent of GDP over the 3-year period, with the fiscal balance including grants shifting to a small surplus.[14] The deficit reduction was to be achieved by higher revenues, with total expenditures remaining flat at around 21-22 percent of GDP.
- Inflation was targeted at a very low 3 percent throughout the program period.

Although the specific quantitative details of this macroeconomic framework changed over time, the overall macroeconomic strategy remained broadly unchanged. (For details of the targets adopted at the various reviews—see Appendix Table 1.) The one important exception was that the fiscal program was gradually adapted (especially at the time of the fourth review) to accommodate additional aid-financed expenditures. However, there was still a strong emphasis on relying on grants to finance the additional contingent spending.

In terms of actual outcomes, the fiscal and aid picture looked markedly different than the original program design. Government expenditures were substantially higher (by an average of 5 percent of GDP), financed by higher aid inflows as well as gains in domestic revenues that exceeded program targets (Table 3). Inflation was higher than the very low program targets but was still generally within single digits.

A new PRGF arrangement adopted in mid-2006 incorporated many similar core elements to the earlier arrangement, but accommodated the higher starting level of grants and expenditures:

- Going forward, total grants were again projected to be broadly flat, albeit at a higher level (i.e., about $340 million per year during 2006-2008). Concessional lending and hence total aid were projected to increase only moderately (Chart 1).
- The domestic fiscal deficit and overall deficit before grants was targeted to decline by only about ½ percent of GDP over the 3-year period. Once again, total expenditures were projected to remain broadly flat, but at their then much higher level of 27-28 percent of GDP.

- Inflation (which had been in the range of 5-10 percent during 2002-2005) was targeted to be 5 percent throughout 2006-2008.

Table 3. Key Macroeconomic Targets and Outcomes Under Programs, 2002-2006

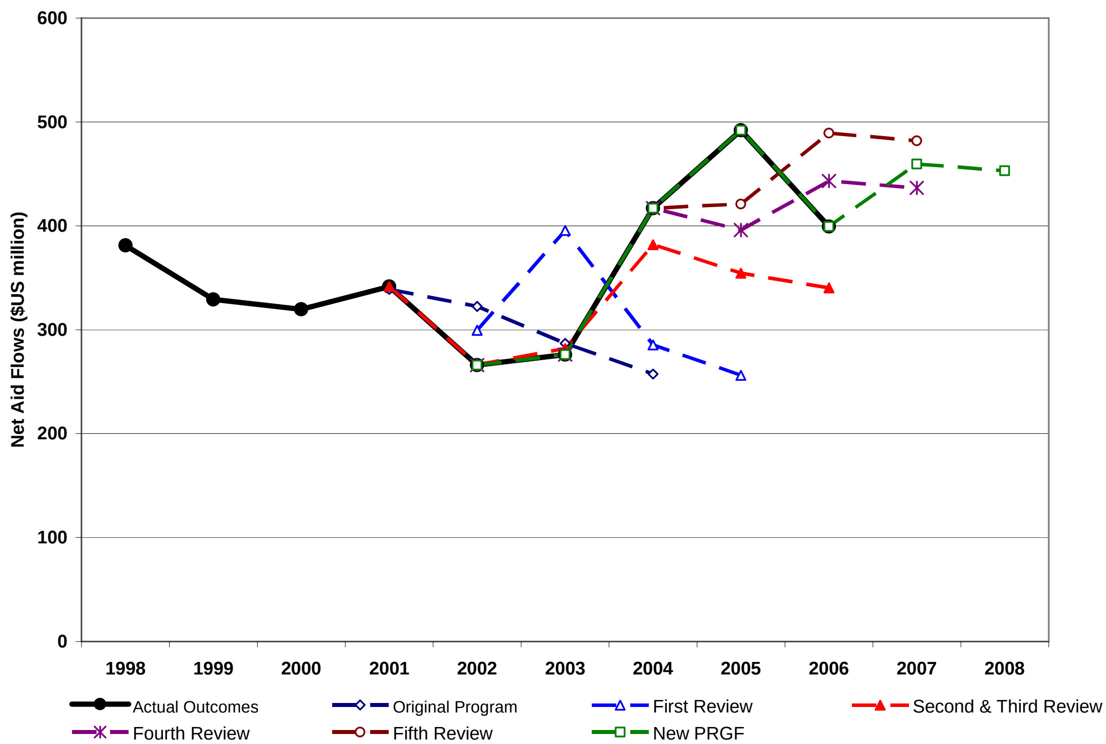
	Original Program Targets [15]	**Estimated Actual**[16]	**Significant modification at program reviews?**
Inflation (percent)			
2002-2004 PRGF	3% a year throughout 2002-2004	Average of 8 %	Gradual revision upward (but with final target at 4 percent)
2006-2008 PRGF	5% a year throughout 2006-2008	N/A	N/A
Real GDP growth (percent)			
2002-2004 PRGF	Average of 6.5 % p.a. during 2002-2004	Average of 4.7 percent	Yes
2006-2008 PRGF	Average of 4 % p.a. during 2006-2008	N/A	N/A
Total net aid flows (in US$ Million) *****			
2002-2004 PRGF	Average of $289 million per year during 2002-2004	Average of $320 million per year	Small increase; large year-to-year fluctuations
2006-2008 PRGF	Average of $437 million per year during 2006-2008	N/A	N/A
Change in overall fiscal balance, before grants (in percent of GDP)[17]			
2002-2004 PRGF	Decline of 1 ½ percentage points of GDP over 3-year period	Increase of 2 ½ percentage points of GDP over period	Yes
2006-2008 PRGF	Decline of ½ percentage point of GDP over 3-year period	N/A	N/A
Change in total government expenditures (in percent of GDP)			
2002-2004 PRGF	No change over 3-year period	Increase of 5 percentage points of GDP over 3-year period	Yes
2006-2008 PRGF	Decline of 1 percentage point of GDP over 3-year period	N/A	N/A
Change in Revenues (in percent of GDP)			
2002-2004 PRGF	1 ½ percentage points of GDP over 3-year period	2 ½ percentage points of GDP over 3-year period	Gradual increase along with better performance
2006-2008 PRGF	½ percentage point over 3-year period	N/A	N/A

* Net of amortization actually paid and including net IMF financing.

Source: Appendix Table 1.

With this background, we look at three major elements of the macroeconomic strategy to ask whether the IMF unduly narrowed the policy space available to the authorities: the overall external aid envelope and judgments on debt sustainability; the fiscal strategy and assessments of the likely impact of additional expenditures; as well as the inflation targets and design of monetary policy.

Chart 1. Projected and Actual Aid Flows



(i) External aid projections and debt sustainability.

Our conclusions are that (i) the aid projections underlying the programs were generally conservative, although the programs did adapt to accommodate higher aid when it was realized. (ii) Too much weight was put on a single indicator of potential debt distress in debt sustainability assessments, causing borrowing on quite concessional terms to be ruled out. It is not possible to judge the overall impact of this constraint (i.e., whether any desirable expenditures were not financed as a result), since substantially higher grants were forthcoming in practice. (iii) Most fundamentally, there was too little exploration of the macroeconomic implications of alternative aid-financed scenarios. Consequently, the original program was not sufficiently oriented toward what was Rwanda's key macroeconomic challenge—managing the consequences of a substantial scaling up in aid-financed expenditures. We will return to this latter issue in the section on the fiscal strategy.

The various tests of aid optimism and pessimism, discussed in more detail in Box 1, suggest the following (see also Chart 1):

- The initial program (and first review) assumed a decline in aid, mainly through lower concessional borrowing.
- Actual aid outcomes were consistently higher than program projections—by an average of $60 million a year.
- Projections of aid gradually became more optimistic, although much of this reflected the de facto recognition of higher aid levels that had already been achieved.
- The assumed growth in aid underlying the programs was consistently lower than what donors were signaling they were prepared to commit in global terms (as reflected, for example, in OECD/DAC projections of global aid flows). This remained the case after the post-Gleneagles commitment to double aid to Africa. None of the IMF staff reports contained a discussion of what the program projections of aid implied in terms of Rwanda's share of global or regional aid flows, beyond statements that Rwanda was heavily dependent on aid and would need to prepare for an eventual decline.

In interviews, IMF staff said that the context in which the aid projections of the program had been determined—notably donors' adverse reactions to political disputes over Rwanda's role in the civil war in the Democratic Republic of the Congo (DRC)—had greatly complicated formulation of the program. By 2002-2003, some donors had become more cautious in their expressions of support and there were some temporary disruptions to aid flows, for essentially political reasons, during program implementation. Moreover, their experience had been that donors often promised more than they eventually delivered. Consequently, the baseline assumption about aid levels and how the program would respond to the inevitable uncertainty about this assumption was a critical program design issue. Staff interviewed said they recognized that it came down to a question of how to balance the risks to macro stability versus the potential costs of disrupting expenditures. They could not present to the IMF Board a program that was underfinanced. Consequently, the uncertain political factors and reluctance of donors to indicate unambiguously their aid intentions had strongly influenced their use of quite conservative baseline assumptions while they were prepared to modify the program (at the time of reviews) to accommodate higher-than-expected grant aid. In early 2005, (at the time of the fourth review), the program design had been modified further –to build in substantial additional contingency expenditures (of 2 percent of GDP), linked to the actual delivery of additional aid (see discussion below).

Government officials interviewed agreed that the short-term nature of many donor commitments (with the notable exception of the UK) and the unpredictability of disbursements greatly complicated their formulation of a macroeconomic strategy and warranted some caution. Budget support predictability has improved since 2002, but remains sensitive to regional and political developments.[18] Clearer medium- and long-term indications of likely aid levels are needed for the efficient planning and budgeting of scaled-up expenditure programs.

The IMF analyses of Rwanda's debt sustainability, discussed in more detail in Box 2, consistently came to the conclusion that the projected evolution in one key indicator (the net present value of debt in relation to exports) signaled a potential renewal of debt distress and that, therefore, Rwanda should avoid most new borrowing on concessional terms and rely almost exclusively on grants. This was the conclusion even after substantial debt relief, including significant "topping up" received at the HIPC Completion point. As a result, the program conditionality excluded all new borrowing that did not have a grant element of at least 50 percent.[20] Indeed, especially earlier in the PRGF period, IMF documents tended to discourage substantial borrowing even at terms that met this criterion.

Box 1. How Realistic Were the Projections of Aid Underlying the 2002-2006 Programs?

To test the degree of 'optimism' or 'pessimism' of the aid assumptions, we compared the original program projections for aid flows (grants plus net loans after taking account of debt relief) as well as those of all subsequent reviews to a series of benchmarks: (i) previous trend growth in aid flows to Rwanda; (ii) expected trends in global aid flows at the time each program was finalized (according to the OECD DAC)[19]; and (iii) actual outcomes (to the extent the data is available). The results indicate the following:

- Actual outcomes for net aid consistently exceeded program projections—by an average of $60 million a year—for those programs for which outcomes are available (Table 2). This largely reflects significantly higher aid flows in the form of grants in 2004 and 2005 than were expected by IMF staff.
- IMF program projections were generally significantly lower than past trends in aid. (The one exception was the projection made at the time of the (combined) second and third review in May 2004.
- IMF net aid projections became higher in succeeding reviews and, in particular, between the first and second/third reviews. The original program projected a decrease in net aid flows by about 8 percent annually; by the fifth review (completed in August 2005), net aid was projected to rise by about 5 percent per year.
- The IMF programs projected that aid to Rwanda would grow more slowly than what donors at the time were indicating would happen to global aid flows. The difference narrowed over time as projections for Rwanda became progressively more realistic, but it remained true for all programs.

Table 5. Comparison of Program Projections for Growth in Aid to Past Trends and Global Commitments
(in percent; based on US$ values; period in brackets is that covered by program projection)[a]

	Original Program (2002-2004)	First Review (2003-2005)	Second & Third Review (2004-2006)	Fourth Review (2005-2007)	Fifth Review (2005-2007)	New PRGF (2006-2008)
Projected Average Annual **Net Aid** Growth	-8.2%	-4.8%	6.9%	1.6%	5.2%	-2.6%
Projected Average Annual **Grant** Growth	-0.4%	4.6%	8.3%	4.6%	9.0%	-8.7%
Projected Average Annual **Loan** Growth	-17.3%	-23.9%	11.4%	-3.6%	-3.6%	17.1%
Trend growth in **Net Aid** over 5 years preceding program/review[b]	3.0%	-0.8%	-5.2%	5.3%	5.3%	10.8%
Growth in total global aid flow projections[c]	8.2%	11.5%	15.4%[d]	13.0%[d]	13.0%[d]	11.4%[d]

Source: Authors' calculations based on data in IMF documents and OECD-DAC.

Notes:
a. Aid flows (in nominal values) are defined as official transfers plus net concessional lending.
b. Average annual trend growth over the period t_{-6} to t_{-1} using the estimated actual aid flows at the time of the program negotiation or review
c. Based upon most recent OECD DAC global aid projections at the time of program negotiation or review.
d. Based on OECD DAC Secretariat projections of Gleneagles commitments. Authors' calculations use 2004 as the base year and interpolate yearly aid flows assuming linear increases.

Table 6. Sums of Net Aid Flows for Projections vs. Actual Outcomes

Actual Outcomes (2002-2004)	**Original Program Projections**	**Actual Outcomes (2003-2005)**	**First Review Projections**	**Actual Outcomes (2004-2006)**	**Second & Third Review Projections**
959	867	1185	937	1308	1077

This led to substantial friction with the World Bank[21]—in part because it implied that IDA financing should be provided on grant terms (which the Bank was initially reluctant to accept) and in part because the Bank took the view that Rwanda would be justified in running greater risks, in terms of a rising debt-exports ratio, if the additional financing was for initiatives with good prospects of raising long-term productivity.[22]

The government (in particular then-Minister Kaberuka) recognized the constraints of the HIPC framework from an early stage, and consistently used international fora to raise the issue. Issues regarding the post-HIPC situation were not raised during IMF missions since it was recognized that the issues involved went beyond the level of the mission staff. However, Minister Kaberuka raised the issue repeatedly with senior Fund management. Dr. Kaberuka also held a Press Conference during the 2005 Annual Meetings in Dubai where he urged a rethinking of the post-HIPC situation to ensure that countries did not have fewer external resources post-HIPC.

Assessing debt sustainability is always a complex issue because it involves making forward-looking estimates about how key economic variables, including policies, will evolve over very long periods. The problem is even bigger for low-income countries like Rwanda because the behavior of donors also has to be projected—will they continue to provide concessional financing on similar terms in the future? So sustainability assessments can only make probabilistic judgments. Moreover, any operational framework has to make enormous simplifying assumptions, which raise difficult questions about the applicability of the framework in specific cases. Put simply, the key question is whether the analytical framework used by the IMF was robust enough to say that a country like Rwanda, with enormous development needs, should turn down aid with up to a 50-percent grant element and be cautious about borrowing even when the grant element of loans was above this level? This is essentially a question of balancing risks (i.e., between foregoing potentially desirable expenditures versus encountering renewed debt problems in the long term) with very incomplete information. On balance, however, we think the framework ruled out some feasible policy options where the authorities should have been given the space and been encourage to consider the tradeoffs they were willing to accept. The following considerations underlie this judgment:

- There is an empirical basis for analyzing debt sustainability based on debt thresholds. The risks of debt distress do seem to rise with the debt level and vary with the quality of underlying policies and institutions (e.g., Kray and Nehru, 2004). But going from a cross-country regression that can, at best, explain only a small proportion of the probability of debt distress to using the results to set specific debt thresholds inevitably builds in large margins of error. These margins are likely to be bigger when only one indicator is flashing warning signs, as was the case in Rwanda. Of course, all operational frameworks have to simplify—but such simplifications underscore the approximate nature of the exercise and the risk of “false positive” signals.
- The IMF staff was right to be concerned about Rwanda’s narrow export base. But long timeframes (i.e., 20-30 years) are involved before most of this debt service falls due, which gives time for policies to adapt further in the future, if needed. Assessing the scope for such adaptation would have required deeper analysis of how alternative fiscal strategies could influence longer-term export growth. Such analysis was not available. But it was probably impossible to answer the question with any degree of certainty, given

the long timeframe involved: Rwanda's exports were so low (in the range of $60-$100 million during 2002-2004) that a few significant investments in new export activities could transform the picture.[23] Given the inevitable uncertainty, the debt sustainability assessment framework that was used involved a very conservative balancing of risks.

- The particular debt threshold used (a NPV of debt to exports of 150 percent) was somewhat arbitrary: it was originally derived from the negotiations over the magnitude of HIPC debt relief and took into account the magnitude of debt relief donors were prepared to finance.[24] Indeed, the interaction between the HIPC debt relief framework and Rwanda's particular circumstances generated some unfortunate results, which are discussed further in Box 2. In sum, an exercise that was meant to eliminate a debt overhang and, in principle, create a situation where rational economic decisions could be made about the merits of new financing decisions became one where the immediate post debt-relief signal became "don't borrow, even on highly concessional terms". This is odd, to say the least. But it was more a result of the overall debt relief architecture than choices made by the IMF team working on Rwanda.

- It is difficult to say what was the impact (in terms of changes in the volume of financing and hence foregone expenditures) of the constraints on borrowing. IMF staff, in interviews, said that donors had responded to the IMF signals of debt sustainability problems by shifting to grants, so overall aid had not been constrained.[25] IMF staff said they were not aware of any projects that had not been funded as a result of the higher concessionality requirement.[26] Interviews with government officials suggest that the limitations on non-concessional borrowing have not had an impact on health expenditure since all donors or potential donors to the sector provide grant aid. The large increase in project support to health seems to support this view.

How much did the initial conservatism about aid flows in the programs matter? It is not possible to say what the counterfactual would have been in terms of aid —i.e., whether higher initial projections would have resulted in an earlier or larger expansion in inflows than that which occurred. Other factors, notably the uncertain politics surrounding Rwanda's role in the DRC, were also important. But the IMF position did have two adverse consequences. First, the signal given by the IMF about the merits of a macroeconomic framework based on scaling up was ambiguous. In this respect, the difference is striking between the message perceived by many donors and the authorities and what IMF staff, in interviews, said they viewed as the message. IMF staff all said that their macroeconomic assessments had never taken a position on the merits of scaling up since they had never been presented with a comprehensive scenario (including the composition of expenditures and their potential sector-level impacts) that would permit such an assessment. In contrast, most others who were interviewed interpreted the IMF-supported program as signaling caution about the merits of more expansionary aid-financed scenarios.

Second, the initial formulation of the program made only a limited contribution to what proved to be the key macroeconomic policy challenge—namely, managing the longer-term consequences of a sustained pick-up in aid-financed spending.

Box 2. IMF Debt Sustainability Analysis for Rwanda

Judgments on the prospects for debt sustainability played a critical role in the formulation of the macroeconomic strategy underlying Rwanda's IMF-supported programs, so it is worth exploring the nature and evolution of the analysis underlying those judgments. Comprehensive debt sustainability analyses were undertaken when Rwanda reached the Decision and Completion points under the Enhanced HIPC Initiative and were updated every time the program was reviewed. More recently, the analysis was undertaken using the IMF-World Bank Debt Sustainability Assessment (DSA) framework.[27] Our review of these various assessments suggests the following:

- Of the various potential indicators of debt burden problems, the one that consistently flashed warning signs for Rwanda—even after debt relief—was the ratio of net present value (NPV) of debt to exports. Table 7, which summarizes the results from the latest DSA exercise (conducted in 2006) is typical: debt/GDP and debt service ratios are well below identified warning "thresholds", while the debt to exports ratio was generally projected to be above the threshold level. This raises the question of whether too much weight was placed on this particular indicator.
- The ideosyncracies of how debt relief was calculated under the enhanced HIPC Initiative (driven in part by budget constraints of the donors who provided the relief), combined with Rwanda's particular circumstances, caused an awkward interaction with subsequent debt sustainability assessments.[28] In effect, the forward-looking debt sustainability assessments were signaling that Rwanda should avoid borrowing even on highly concessional terms immediately after a debt relief exercise that had been designed in principle to remove such distortions to economic decision-making caused by an unsustainable debt overhang.
- The debt sustainability assessments did not analyze how choices on the level and composition of expenditures could influence the path of exports (and other tradables). This was not really the fault of the IMF staff—since it would have been difficult to do in the absence of more specific sector-level analysis on the likely productivity effects of different expenditures—but the absence of such linkages in the analysis meant there was no way of judging how specific expenditure choices could affect the future capacity of the economy to support debt.

Table 7. Rwanda's external debt indicators compared to the policy-based indicators of potential debt distress under the DSA Framework

(*In percent*)

	Threshold indicators of potential debt distress*	Rwanda's	ratios
		2005	2006-2029 Annual average
NPV of debt to exports	150	59	153
NPV of debt to GDP	40	6	18
Debt service in percent of exports	20	6	4

Source: IMF Country Report No. 06/245 (New PRGF request, May 2006).

** For a country like Rwanda with policies rated as "medium."*

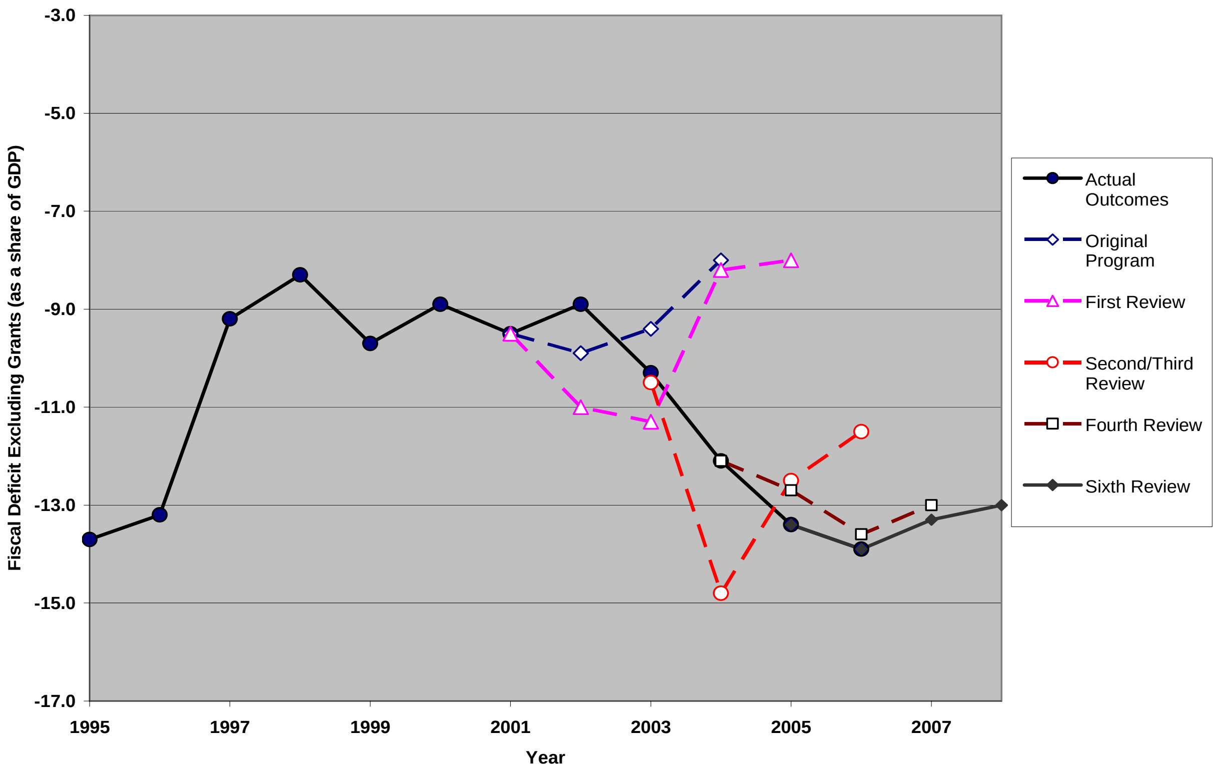
ii. The fiscal strategy

Our overall conclusions are that (i) the initial program design (in 2002-2003) was too cautious in terms of balancing potential risks and rewards of scaling up spending; but actual implementation of the programs did show considerable flexibility, especially in later periods. (ii) The two fundamental reasons for the IMF caution were considerable uncertainty that donors would actually deliver higher aid, and the lack of any reliable analysis to help judge what would be the impact of expenditures on growth and poverty. (iii) In this latter respect, the PSIA was a missed opportunity to explore alternative policy option and models. Exploring the reasons why can suggest some lessons. (iv) The IMF could have done more to explore alternative scenarios for aid and expenditures, but this would have also required better analysis by others of specific expenditure initiatives. In particular, it is critical to "think long term" when considering the fiscal consequences of scaling up aid-financed health spending. This would require the IMF to diversify the types of analysis and models it employs to take more account of longer term supply-side factors.

The key facts about the various fiscal programs and actual outcomes are illustrated in Charts 2-3 and Table 3 and can be summarized as follows:

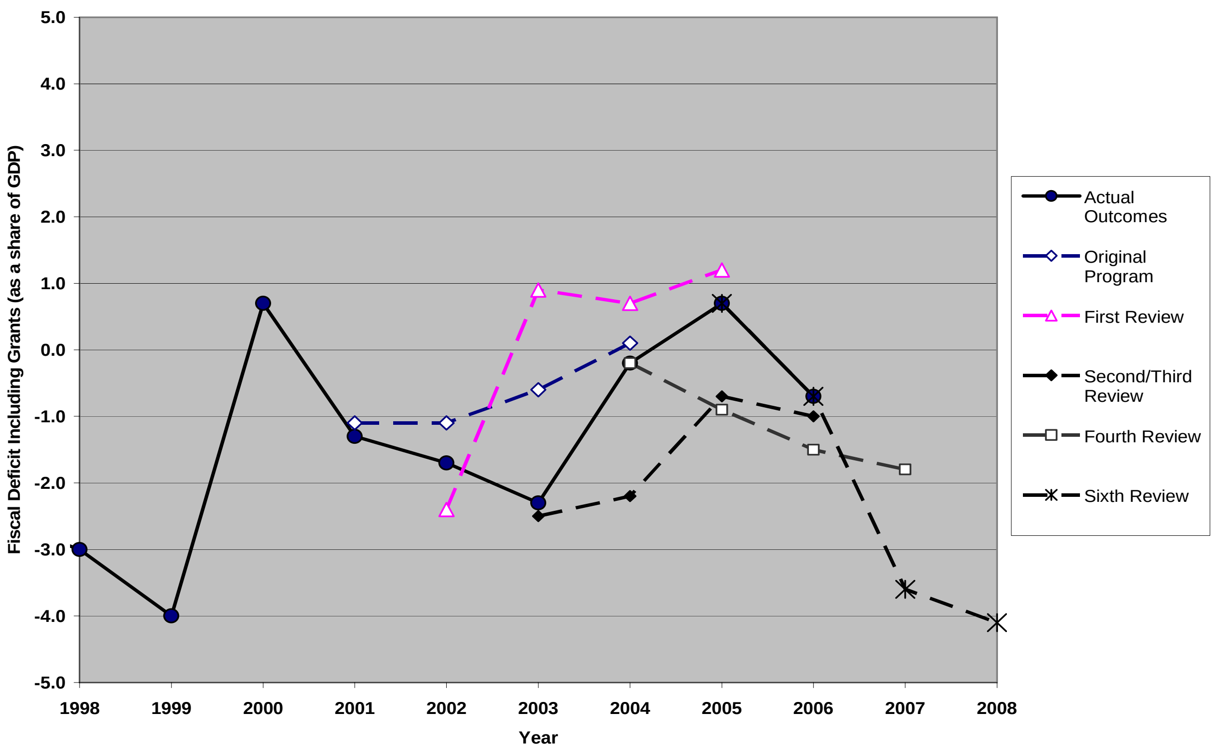
- The initial 2002 PRGF took a rather conservative position, targeting declining deficits and broadly flat expenditures (around 21-22 percent of GDP). In particular, the fiscal deficit after grants was targeted to move into surplus in the original program and even more so in the program agreed at the first review (which was concluded in May 2003, shortly after the debate triggered by the DFID-financed PSIA).
- Later programs were gradually modified in the direction of larger aid-financed deficits.[29] The changes in the targeted path of expenditures are particularly striking (Chart 3): initially, the modifications envisaged a temporary expansion in expenditures for about a year, followed by renewed consolidation. This reflected concerns that the pick up in aid would not be sustained. However, from the fourth review (March 2005) onwards, the programs envisaged that the scaled-up expenditure levels (now around 27-28 percent of GDP) would be maintained over the medium term.
- Spending on priority categories, including health, was targeted to increase significantly reflecting in part savings from HIPC Initiative debt relief and cuts in other spending (e.g., on defence). The program was one of the first to include explicit fiscal conditionality (a floor) on such spending, with most of the priority categories being for recurrent expenditures. We discuss the treatment of priority expenditures in the next section.
- The program targeted a significant increase in revenues because the low starting point (a revenue/GDP ratio of about 11 percent) would leave the fiscal position and key expenditures even more vulnerable to fluctuations in aid flows. The strategy to raise revenues (relying on strengthened tax enforcement as well as an increase in the value-added tax) achieved its objective, with revenues eventually rising to 14-15 percent of GDP.

Chart 2a. Programmed and Actual Fiscal Adjustments



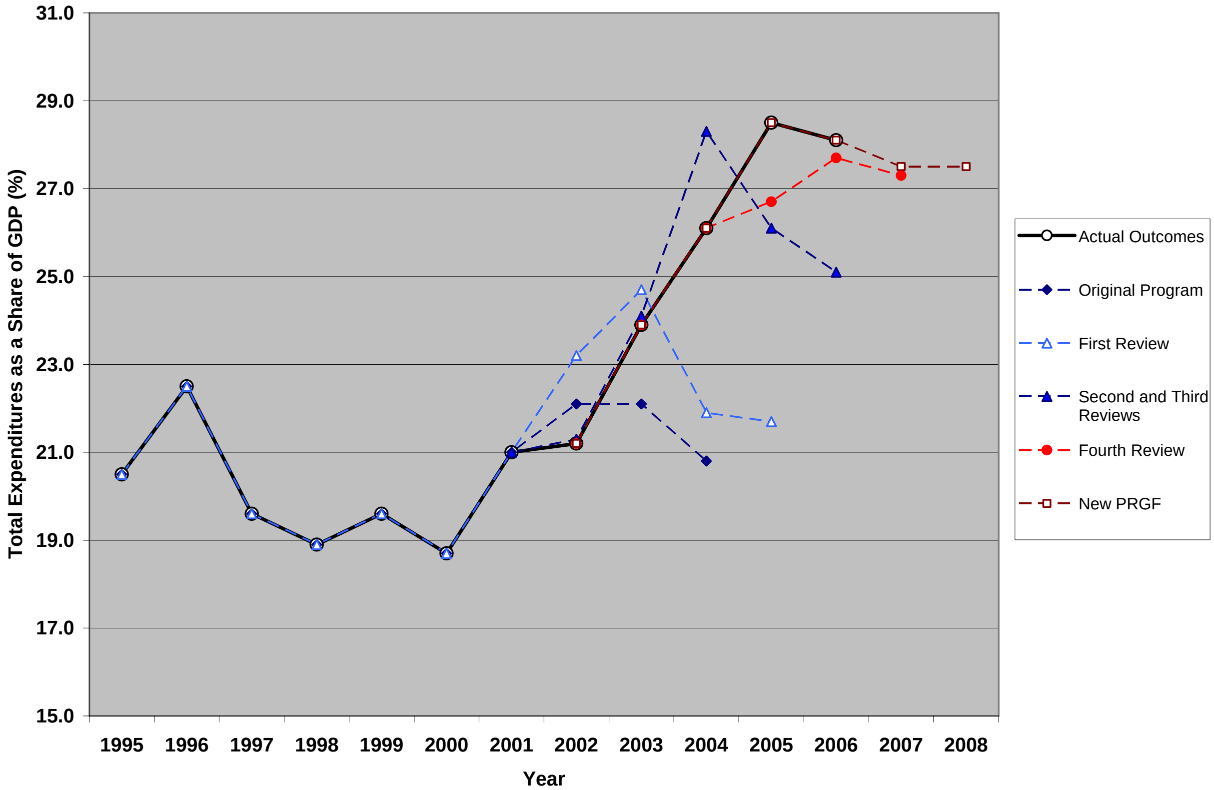
Note: Fifth review targets were largely the same as those of the fourth review and are not included

Chart 2b. Programmed and Actual Fiscal Adjustments



Note: Fifth review targets were largely the same as those of the fourth review and are not included

Chart 3. Rwanda Total Expenditures as a Share of GDP



Note: Fifth review targets were largely the same as those of the fourth review and are not included

Although there was some variation in government officials' views of the nature and appropriateness of the IMF message and approach, interviews suggest overall consensus on three broad points. First they regarded IMF programs, especially during the earlier part of the period covered by this review, as unduly constraining feasible fiscal options, with too little attention to longer-term supply-side consequences. This may have had some indirect impact on health spending, although the latter did grow fast (see below). The root cause of this constraint was the IMF's reliance on a short-term model, and the pessimistic assumptions (particularly on growth and aid) fed into the model. Second, however, there is also consensus that the IMF has consistently favoured health expenditure, accommodating increases from 2003 onwards and encouraging increased expenditure (for example, through the priority expenditure targets).

Third, officials agreed that the IMF's message on fiscal strategy has evolved over time. *Between 1995-1999*, there was broad agreement between the Government and the IMF on the nature and role of the program. Government capacity was limited, and the IMF program was necessary to ensure a focus on re-establishing macroeconomic stability, revenue effort and basic institutions whilst attracting donors and debt relief.

From 1999-2002, government capacity increased and its priorities shifted to longer term growth and development issues. In this context, those interviewed thought the IMF was not sufficiently flexible and the IMF program became too restrictive. The message received by Government was that there should be no increase in the domestic fiscal deficit (fixed at around 8 percent of GDP), even if additional grants became available.[30] Any increases in social sector spending had to be financed by reductions in military and other "non-priority" spending. The IMF's key justification was that of the sustainability of spending – increased grants were assumed to be temporary and if spent could increase "core" expenditure that would be difficult to reverse and would then have to be financed through domestic borrowing if grants dried up.

From *late 2002-2003*, the IMF showed signs of increased flexibility (in part due to a change in mission chief as requested by the government). Increases in expenditure were accommodated if they were temporary, well-planned and on priority sectors (including health). Macroeconomic slippages in 2003 caused delays, but the IMF ultimately accommodated these slippages and was keen to agree a revised program including a medium term expansion in the fiscal deficit.

From *2004-2006*, the IMF took a much more flexible approach. The domestic fiscal deficit was allowed to widen to 10-11% in addition to allowances for "contingent spending" (of up to 1.5% GDP) if additional grants became available. The contingent expenditure approach reflected the IMF's position that any aid should be accepted and spent, whilst ensuring it was spent on "priority" areas (including health) and minimising the risks to macroeconomic stability. The emphasis on the sustainability of expenditure faded, to be replaced by a focus on managing the domestic demand impact of additional aid financed expenditure. Despite its increased flexibility, the Fund still insisted that proposed budgets for 2004-7 were cut and reallocations made from "non-priority" to "priority" sectors. Increased attention was paid to longer term issues, such as export promotion and the need for increased spending on the productive sectors to ensure increased domestic supply response.

The contingent expenditures approach emerged as a temporary compromise to allow significant fiscal expansion whilst limiting risks to macroeconomic stability.[31] It formalizes the IMF's pledge to allow countries such as Rwanda to spend any aid, provided that it is spent on priority areas and that the macroeconomic situation is stable. However, the approach has some operational drawbacks and is not a substitute for a more comprehensive medium-term scaling-up strategy. First, the definition of contingent expenditures has usually been agreed after the annual budget has been adopted by Parliament. As such, it had no basis in Rwandan law, undermined domestic accountability and complicated budget monitoring mechanisms.[32] In effect, it was an agreement between MINECOFIN and the IMF as to which expenditure programs to hold back until the end of the year.[33] Health expenditures have not been affected by the contingent expenditure approach, as no health program has ever been defined as contingent; most contingent programs relate to the productive sectors. However, release of the contingent funds has usually come late in the fiscal year (around September, based on July benchmarks), leaving insufficient time to spend effectively. One official estimated that only 50 percent of contingent spending had been executed. However, a different approach was taken for the 2007 budget, rather than being based on a mid-year budget amendment, the contingent expenditures were incorporated into the initial budget process.

From *late 2006 onwards*, the IMF has becomes more concerned about emerging macroeconomic pressures, and there continue to be differences of view about the appropriate monetary/exchange rate policy response to manage the macroeconomic impact of increased expenditure, whilst continuing to allow additional aid to be spent (see next section). At the same time, the government is finalising the EDPRS and is proposing significant increases in expenditure, particularly on infrastructure. As a result, a period of increased tension between the IMF and government over macroeconomic strategy may be emerging.[34]

This history illustrates the crucial role of expenditure analysis in setting the fiscal path. Since the choice of fiscal strategy cannot be independent of the composition and likely effectiveness of expenditures, the IMF should draw on sectoral analysis when making its macro judgments. IMF staff who were interviewed all emphasized that—throughout the period covered by this case study-- they had very little solid information on the links between additional public expenditures and growth or poverty reduction. In that sense, formulation of the macroeconomic and fiscal framework was like Hamlet without the Prince. The following factors contributed to this lack of integration between expenditure analysis and macroeconomic assessments of the fiscal path:

- In some key areas, such as agriculture, the Government's strategy lacked, in the words of the independent evaluation of the PRSP, "real prioritization or a framework linking priorities to what is feasible over the short to medium term. …In fact, since the PRSP document was published, the policy matrix for agriculture has been a moving target…" (Evans et al (2006) para 3.10). There were also significant challenges to and shortcomings with the labor-intensive public works (HIMO) program envisaged in the PRSP. But the development of concrete sector-level strategies was not such a constraint for the health and education sectors, where strategic plans emerged with some linked to medium-term expenditures proposals—if not always to actual expenditures.[35]
- Limited World Bank analysis on the constraints to growth and the overall public expenditure review. The sectoral analysis undertaken was limited to sectors where the Bank had active lending operations (e.g., health, education, some energy). A Country Economic Memorandum explicitly focussing on the constraints to growth and possible response strategies has been under preparation since 2004, but has not been widely discussed.
- The institutional framework to ensure coordination between those concerned with macroeconomic policy issues and those involved in sector strategies and expenditure analysis (e.g., the budget support donors) has not always worked well.[36] Earlier in the period covered by this review, donors were reluctant to seek substantive IMF involvement or advice into the dialogue on sector strategies, partly from a fear of introducing what some viewed as an inflexible partner into the process.
- The PSIA was a missed opportunity to explore and fill the gaps and help broaden the debate, for several reasons:
  -- There were a number of process issues that undermined the PSIA. The tone of the first draft was somewhat counter productive and set up an antagonistic response by the IMF. The authors also felt under pressure to get produce a draft for two key meetings in Kigali and Washington. However, it was actually too early to be circulated – there were significant gaps. Momentum was lost in the process and the final draft came out very late and fell by the way side. The authors of the PSIA also felt that they had not sought to include IMF staff in the process early enough. All this contributed to a response that did not focus on identifying key information gaps and seeking collaborative approaches to filling them, which might have yielded better outcomes.
  -- The initial idea of a PSIA was to link micro level analysis to the macro-level (i.e., to look at what would be the growth and poverty impacts of specific expenditure initiatives). What the PSIA ultimately focused on was building a macro model. The

review of the PSIA by Chris Adams focused on the model structure, which he considered fairly robust – it was formal and systematic. However he also concluded there was a mismatch between ambition and purpose of the work. The nature of the questions being asked meant that ultimately no single model would have be appropriate to answer it. He concluded that the questions need to be addressed by a suite of models (an approach the IMF also needed to take on board). The macro modeling approach ultimately taken in the PSIA meant that it was difficult to make the links with specific micro-level analysis and therefore the assumptions on which the model and its conclusions were based were easily challenged.

-- The main objections from the IMF at the time were, first, that this was not a valid subject for a PSIA (which does not appear to be a legitimate critique) and, second, that the PSIA relied too heavily on a simple debt dynamics model (linking growth and the interest rate, with problematic assumptions around what would generate the necessary foreign exchange resources to service the debt). The latter criticisms were certainly valid. However there was no attempt by the IMF to explore the implications of different assumptions and formulations.

-- IMF staff concentrated on attacking the technical underpinnings of the first draft of the PSIA because of a (legitimate) concern that the assessment was promoting a large increase in expenditures without a sufficient grounding in evidence on the likely effectiveness of those expenditures. In practice, however, any efforts to link the micro- and macroeconomic analysis in a dynamic model are bound to require enormous simplifications. The weaknesses of the datasets are considerable and microeconomic analysis of both the growth and potential poverty reducing benefits of additional spending is very difficult, so attempts of this sort are always easy to attack.

-- In sum, the PSIA was an ambitious effort that fell well short. It had technical shortcomings that the IMF was right to point out. But the exercise should have been used as the starting point for a continued, more collaborative exploration of what was (and is) one of the central issues for Rwanda's long-term fiscal strategy: namely, the likely longer term effects on the supply side of substantial expansion in public spending.

What should the IMF have done in absence of sufficient information to integrate expenditure analysis and macro assessment? Three important messages emerge. First, there is a need for much greater clarity about the IMF role and the nature of the macroeconomic assessments it is making: if it does not have the necessary information to make an assessment of scaling-up scenarios, it should say so and be very clear about what it is assessing. Second, there is the need for a stronger coordinating framework to identify and help fill information gaps. The framework would spell out who is expected to do what in terms of analytical assessments and should be built around the authorities' strategy and priorities. Finally, even with such efforts, enormous uncertainties will remain. On issues such as the long-term supply response of the economy to spending initiatives, there may be no way of knowing in advance.

iii. Inflation targets and monetary policy

The IMF's own general policy advice on the appropriate inflation targets in low-income countries suggest that it is not advisable to target inflation below about 5 percent, given the potential magnitude of supply shocks that such countries may be subject to and that it is appropriate to accommodate the first round impact of any adverse shocks on inflation, but not any second-round effects (IMF, 2005). Judged by the former criterion, the very low (3 percent target) of the original program went beyond the available evidence. But in practice, the IMF programs have accommodated overshooting of these targets which suggests some greater ex post flexibility (see Appendix Table 1).

A more fundamental issue may be the potential disconnect between the exchange rate policy being pursued by the Central Bank and the way the monetary ceilings under the IMF program have been formulated. The IMF has recommended that the authorities allow greater nominal appreciation of the exchange rate (by selling more of the foreign exchange proceeds derived from higher aid that is not immediately spent on imports). The Central Bank has been reluctant to do this because it believes that the demand for foreign exchange is inelastic and that greater foreign exchange sales would lead to a large (and volatile) movement in the nominal exchange rate. In response to this reluctance, the monetary ceiling in the IMF program is defined in terms of reserve money (i.e., the overall assets of the central bank) rather than the more usual component of net domestic assets (NDA only).

This may sound like a minor technical issue—and it is, *provided* everything turns out as originally expected. However, if some aspect turns out differently than originally programmed (e.g., aid inflows are higher or the demand for money is higher than expected—perhaps because growth was higher than expected—which it often has been), then targeting reserve money rather than NDA can imply a very different balancing of risks. A reserve money ceiling usually only adopted in cases where there is a concern that a massive inflow of (usually private) capital flows will put upward pressure on the money supply and hence inflation. Essentially what the program is saying to the government is, if you accumulate higher-than-expected reserves, you must 'sterilize' the monetary consequences. (The IMF would prefer that the central bank not accumulate excess foreign exchange in the first place.)

We have some sympathy for the IMF arguments on the exchange rate, since ultimately the only ways to both "absorb and spend" any additional foreign exchange is to allow a real exchange appreciation or to use the aid to finance government spending with a high initial import content (which would not include salaries in health or education). But whatever the merits of the underlying argument about exchange rate policy, using a reserve money ceiling does not seem like the right approach for monetary policy in a country like Rwanda--unless there is a strong risk of reigniting major inflation. The IMF argues that this is indeed the case—and it is true that inflation has accelerated recently (to around 11 percent). But something has to give unless the additional aid is to be turned down (or put into reserves without any corresponding fiscal spending, which could be a short-term solution but not one donors would tolerate for long). In the absence of nominal exchange rate appreciation, some temporary pick up in inflation may be the only device to bring about the necessary shift in relative prices to allow the aid to be absorbed.

b. Short-term program design –response to aid shocks and expenditure smoothing

An important but little understood issue in IMF program design is how programs adjust to unanticipated shocks—especially to aid. The issue is important because the adjustments determine whether macroeconomic policies focus on cushioning expenditures in the event of adverse shocks (at the expense, say, of additional domestic financing and running down external reserves) or of requiring expenditures to adjust. Similarly, the adjustors determine whether higher-than-expected aid can be spent. These choices can be especially important for expenditures like health that are costly to disrupt. The issue is little understood because the adjustments are often complex and are typically described, in non-transparent terms, only in technical annexes to IMF documents.

The precise nature of the program adjustments to aid shocks in Rwanda varied from review to review. The early programs generally put much less emphasis on cushioning expenditures and typically involved an asymmetric adjustment to positive and negative shocks (see Table 8). In effect, the early program design reflected an implicit judgment that the potential "costs" of using external reserves to smooth such shocks outweighed the benefits of smoother expenditure planning and implementation.[37] Later programs shifted to a greater emphasis on allowing higher-than-projected aid to feed into additional expenditures (at least up to the extent of the identified contingent expenditures) and for the impact of aid shortfalls on expenditures to be cushioned in the short term.

Our conclusion is that a program design that leaned more in the direction of expenditure smoothing from the outset would have been justified-- given Rwanda's substantial external reserves and the fact that the degree of permanence of any such shock could always be reconsidered at the time of the six-monthly program reviews, But the program design did shift subsequently in favor of greater fiscal flexibility. Especially since early 2005 (the fourth review), there has been greater emphasis on cushioning expenditures from adverse shocks to aid and on allowing positive aid "surprises" to be spent.

c. Treatment of priority spending, including health, under the programs

The IMF programs with Rwanda were unusual since they included formal conditionality on minimum levels of recurrent spending on certain priority categories.[38] The Government began in 1998 to identify certain expenditures in the budget as priority program areas (PPAs), starting with social sectors (health and education). The process of expenditure prioritization expanded with the understanding that budget savings from HIPC debt relief would be used to increase budget allocations to the PPAs, which were to be selected on the basis of high impact on social rehabilitation and poverty reduction. These allocations were to be protected from any cuts in mid-year budget reviews and could be increased if additional resources became available. The list of priority programs gradually expanded as the PRSP process advanced and now includes key programs in the health and education sector, HIV/AIDS prevention, gender equality, key economic services in agriculture and rural infrastructure, as well as administrative services such as justice and law enforcement. The electricity sector was added as a priority area in 2005 in response to the adverse economic impact of power shortages.

Table 8. Rwanda: How Programs Adjusted to Aid Shocks

	Nature of adjustment*	Implications
Original Program (July 2002)	Ceiling on net credit to government (NCG) is reduced by full extent of higher-than-programmed inflows of external budgetary support (defined to include grants and loans other than those financing specific projects). No adjustment for shortfall in external budgetary support. There was also a ceiling on the domestic fiscal deficit (defined as revenues minus non-interest current spending minus domestically financed capital spending)—with no adjustments for aid shocks.	Program requires higher-than-projected budget aid to be fully saved. Any shortfalls require fiscal adjustment.
First Review (May 2003)	As above, except ceiling on net credit to government was raised by shortfalls in external budgetary support (up to a full-year maximum of $30 million).	Program still requires higher-than-projected budget aid to be fully saved but provides for some moderating of fiscal adjustment (up to a threshold) in the event of aid shortfalls.
Second and Third reviews[39] (May 2004)	Similar to above for net credit to government. Ceiling on the domestic fiscal deficit revised by any shortfall in external budgetary grant inflows, up to a maximum of $25 million.	Similar to above.
Fourth review (May 2005)	The program established baseline levels of budget support. Domestic fiscal balance and net credit to government (NCG) was allowed to exceed the program ceilings to support additional contingent expenditures (up to limit of about 2 percent of GDP for full year) to the extent that actual budgetary support exceeded the baseline levels. The NCG ceiling could also be adjusted upwards to the extent that external budgetary support fell short of the baseline (up to a maximum of $30 million). Adjustments only kick in if monetary program is on track.	Complex adjustments but net result is a shift toward allowing higher-than-projected aid to be spent and for slightly greater expenditure cushioning in the event of an aid shortfall
Fifth review (August 2005)	As above	As above
New Program (May 2006)	Domestic fiscal deficit adjusted to allow for additional - contingent spending provided additional grants available and provided monetary program is on track. Also, deficit adjusted automatically for additional spending on food imports. Ceiling on net credit to government adjusted downward by any excess in grants and loans and upward by any shortfall in grants from baseline level (up to a maximum of $30 million)	Complex adjustments but program provides for some additional contingent spending provided additional grants available and monetary program on track and for some expenditure smoothing for a shortfall in grants.

* The focus here is on the program adjustments to the fiscal targets, including net credit to government; typically, there was a corresponding adjustment to the target for net international reserves.

Source: Technical Memoranda of Understanding in IMF program documents.

According to interviews with IMF staff and government officials, the IMF role in this process was a passive one, confined to monitoring and reporting on the expenditure outcomes. The Fund had always taken the targets for priority spending that had been given to them by the authorities, including for the health sector.

Overall, priority spending targets have contributed (along with several other factors, including pressure from budget support donors) to increases in the flow and predictability of funding to priority sectors such as health. This was particularly true in the early days of the PRGF, when priority spending was largely limited to health and education, and fiscal space was very limited. They have provided a means for the IMF to signal that despite its overall cautious fiscal approach, it supports increased spending on health (although discussions on the priority spending levels are largely handled by the World Bank).

However, there are a number of problems with the priority spending concept:

- It has no basis in Rwandan law, as the categorisation is not presented to Parliament. As a result, the categorisation is not communicated to line ministries. With the introduction of the Organic Budget Law, which passes responsibility for budget execution to spending agencies, priority spending benchmarks will become difficult to meet, as they are no longer directly under MINECOFIN's control.
- The definition of priority expenditure is problematic. From the Government side, it risks becoming a list of donors' priorities rather than of government's priorities. From the donor side, the indicator risks becoming meaningless as more and more programmes are added to the definition. It also fails to take into account intra-sectoral issues. For example, all health spending is defined as priority. Attempts to redefine and formalise the definition of priority spending programs have met with Government resistance.

Table 9. Rwanda: Trends in Priority Government Expenditures, 1998-2005

	1998	1999	2000	2001	2002	2003	2004	2005	2006
Total government expenditures	18.9	19.6	18.7	21.0	21.2	23.9	26.1	28.5	28.1
Total priority expenditures	2.8	3.9	4.0	5.3	6.2	6.9	8.5	10.1	10.9
Of which: Health	0.4	0.5	0.6	0.7	0.8	0.6	1.0	1.3	1.4
Education	2.2	3.2	3.2	3.5	3.9	4.2	4.0	3.9	4.5
Memorandum items: HIPC debt relief	0	0	0	1.4	1.5	1.3	1.4	1.5	1.0

Sources: Rwanda: Enhanced HIPC Completion Point Document, March 2005 and IMF documents.

It is not possible to say how this process of setting priority spending categories affected overall expenditure allocations, but the following points are worth noting:[40]

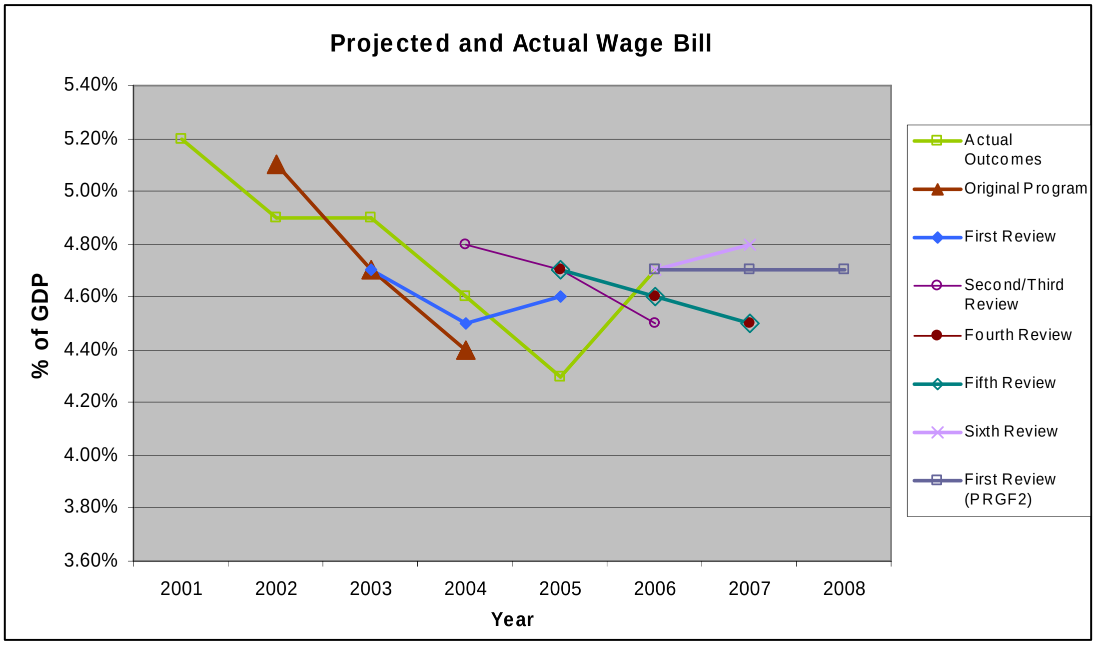
- Total spending on categories designated as priorities have risen sharply since 2000—and by much more than the budgetary savings from debt relief (Table 9). Part of this increase reflects the expanding definition of priorities.

- Although the priority expenditure categories follow quite closely the broad objectives set out in the PRSP, in practice the definition of priority spending is weak.[41] By 2005, the budget identified 25 priority areas, many of which were not closely linked to achievement of PRSP objectives or Vision 2020. Moreover, allocations to broad priority categories are not necessarily an indication of how "pro-poor" the spending has been, since budget allocations at the sub-program level have sometimes reflected different priorities. For example, Evans et al, (2006) report that while budget allocations for health increased significantly in 2004, allocations for tertiary services increased by more than for primary and secondary services. They also report that basic health services were underfunded while provinces received less than their budgetary allocation; in contrast tertiary health received more than their allocated budget—see Evans et al.(2006) para 4.36]

d. Wage bill negotiations

Although there was never a formal benchmark on wages in the program, Rwandan officials said that PRGF negotiations have always included discussions on the wage bill ceiling as a share of GDP. Since 2002, program estimates have consistently limited the wage bill to under 5 percent of GDP, with forward projections of a gradual decline. (See Chart.) Wage bill outturns were below program projections in 2004-6, as the budget contained provisions for unfilled posts. Fund missions have emphasized the importance of signalling through Board documents that the wage bill is not rising, especially through generalized wage hikes.[42]

However, significant expenditure (up to 50 percent of the reported total) on wages and salaries exists outside of this figure. This is because the pressure to hold down the announced wage bill as a percentage of GDP creates an incentive for spending on wages to be shifted to other budget classifications, including under "transfers", "goods and services", and in the capital budget. In the health sector, a significant proportion of salaries are in the capital budget (e.g., under Global Fund projects); salaries for tertiary institutions are under transfers; and salary top-ups for health workers in primary and secondary centers are under the performance based contracting scheme that appears under the goods and services classification. This distorts the budget, which becomes non-transparent and difficult to analyze.



e. Process of program negotiation

There is broad consensus amongst government officials, donors and other commentators that the IMF's analytical approach has been too short term and static, albeit with gradual improvements in recent years. In the Rwandan context, the IMF's focus on short term macroeconomic stability was appropriate during the post-conflict recovery phase, when the government's priorities were to re-establish macroeconomic stability and secure HPIC debt relief. However since the late 1990s, the Fund's approach generated much more controversy. Some government and donor officials interviewed accused it of being "amazingly blinkered" and preventing Rwanda from spending and taking the risks necessary for investment, growth and development.

Government officials recognised that there has always been some degree of flexibility and genuine negotiation over the content of the programs. However, when there were major differences of view, the outcomes of negotiations favored the IMF position because of the Government's dependence on IMF signalling and 'gatekeeper' role for budget support and debt relief.[43]

In this context, there was very little discussion in IMF papers of alternative policy strategies and the potential tradeoffs involved. Indeed, there was a tendency to downplay potential disagreements over strategy. IMF staff said in interviews this reflected a reluctance to convey an impression to the IMF Board and external stakeholders that there were any doubts about ownership/commitment to the program. The staff report on the original (July 2002) program did mention the initial disagreements with the authorities, but only to explain the reasons behind the delays in negotiations and consequent interruption to IMF arrangements. There was no systematic discussion of the authorities' original strategy or the tradeoffs/different balance of risks it might have implied.

During Article IV missions, medium-long term economic issues have been more prominent. The discussion was usually in rather general terms, reflecting the expertise of the IMF staff, but there has been some increase in the attention to supply-side issues, including the obstacles to growth. Some issues (e.g., HIPC architecture) are recognized by the Government to be beyond the scope of national negotiations.

One of the key messages to emerge from the earlier discussion is the lack of integration between the forward-looking macroeconomic assessments and sector-specific expenditure plans. Part of the explanation for this weak integration is that there were important gaps in information about the strategies for some sectors and hence about the resource consequences and potential tradeoffs that they implied, especially until after 2003 [44] But this factor became less important over time as quite specific strategies, supported by medium-term expenditure frameworks, were developed for the health and education sectors, water supply, and (more recently) energy. As will be discussed in the next section, these strategies and expenditure frameworks still had problems; moreover, those concerning sectors critical for growth performance, such as agriculture and rural development, were the least advanced. Nevertheless, the extent to which the formulation of the macroeconomic framework underlying the IMF-supported programs was separate from the debate over the long-term fiscal consequences implied by these expenditure choices is striking.

This "divorce" of the technical macro assessments from considerations of tradeoffs between longer-term expenditure choices was also unfortunate because it tended to reinforce a broader (artificial) separation between the "technical" aspects of the policy agenda and fundamental political choices. The reasons for this separation are complex and go well beyond the IMF.[45] However, there is little capacity elsewhere within the bilateral donors and even the World Bank to undertake the relevant analysis. If the IMF is going to continue to have the roles as macroeconomic policy advisor to the authorities and provider of signals to donors on the merits of the overall macroeconomic framework it may well have to take on this role to some extent and develop the necessary analytical expertise to explore such issues. (This does not mean it should become responsible for analysis of sector-specific issues.) In any event, the IMF should not remain passive when confronted with gaps in information that hamper a comprehensive macroeconomic assessment of scaling-up scenarios. To do so would raise the obvious question of what exactly the IMF long-term sustainability calculations are based on.

Most interviewees responded positively to the idea of the IMF working with multiple scenarios enabling an assessment of the balance of risks and suitable policy responses to the challenges of scaling up. Most argued that this would have to be part of an overall shift in the Fund's role and approach from one of negotiation and enforcement of programs to one of advice. The Board documentation for the first review of the new PRGF released in February 2007 contains a brief description of an alternative "scaling up" scenario developed by Fund staff to demonstrate the macroeconomic challenges of scaling up. It remains to be seen if this approach will be used by both sides in the future.

III. Budgetary Processes and the Health Sector

a. Planning and Budgeting Processes

Rwanda's systems for the planning and implementation of expenditures have improved considerably in recent years. However, the lack of sufficiently concrete sector plans in some areas has limited the ability to translate national strategic planning into prioritization of resources through the annual budgets. Moreover, in some areas (such as the health sector) where clear strategies exist, the activities of a wide range of donors still contribute to the fragmentation of planning and resource allocation.

The adoption of a three-year rolling MTEF framework beginning in 2001 represented an significant improvement but there still exists a major disconnect between national strategic planning, the MTEF, and resource allocation through the annual budgets. Some sectors (particularly education, water and health) are at the forefront of efforts to eliminate this disconnect. However, the MTEF is not presented to Parliament, and the annual budget presented to Parliament does not include the two forward year estimates of the MTEF. Dialogue and accountability around the MTEF is largely with budget support donors rather than internal stakeholders.

Reform of Rwanda's public financial management system has accelerated with the adoption in 2006 of the overarching Organic Budget Law and the related Financial Regulations.[46] The first consolidated public accounts since the 1980s will be produced in 2007, with technical assistance. The Office of the Auditor General is building capacity and a stronger reputation.

Budget predictability as well as strategic and cash flow planning has been hampered by the uncertainty of external aid flows and weaknesses in treasury management.[47] Improvements in both budget support predictability[48] and treasury management[49] (with the assistance of IMF AFRITAC) have reduced this problem. Whilst there are still problems relating to the profile of expenditure over the fiscal year, MINISANTE staff reported that the predictability and timing of in-year cash flows have improved significantly in the past 2 years.

A substantial proportion of donor-financed expenditures are not yet integrated into the MTEF. Forecasting and monitoring of the execution of these expenditures has improved, but remains a challenge. Aid commitments remain too short-term for planning purposes (with the notable exception of DFID, who have experimented with providing a longer term framework).

b. The Health Sector Strategy and Impacts

The Strategy. The current Health Sector Strategic Plan (HSSP) was developed in 2004 (with the assistance of the World Bank and other donors) and covers the period 2005-2009. It was developed as the instrument to make the Health Sector Policy operational and was intended to link the sector objectives and interventions to the national budget under a single operational framework and to help integrate the activities of all stakeholders in the sector. Prior to this, broad strategies were in place but without a clear operational plan.

The Policy and Strategy are structured around 7 goals: (i) to improve the availability of well-qualified health professionals, especially in rural and other underserved areas; (ii) to improve the availability of quality drugs, vaccines, and consumables, especially essential drugs, routine vaccines, and family planning procedures; (iii) to improve geographic accessibility of health services, with equipment and infrastructure standards established according to the functional needs of each facility; (iv) to improve financial access to health services, particularly among the poorest, by expanding public funding of health services and promoting community financing mechanisms such as *mutuals*, systems of pre-payment, and health insurance; [50] (v) to improve the quality of and demand for health services in the control of diseases, with the focus on strengthening high-impact interventions on the control of diseases that are the main contributors to the burden of morbidity and mortality and to the loss of productivity in the country, as well as the main determinants of maternal and child health; (vi) to strengthen national referral hospitals and treatment and research centers; and (vii) to strengthen the sector's institutional capacity, including through the development of a sector-wide approach to coordinating internal and external interventions in the health sector and the use of a Medium Term Expenditure Framework (MTEF) as a key tool for planning and management of the health sector. A cross-cutting strategy has been the roll-out of performance contracting schemes, whereby health centers and district hospitals sign performance contracts with the district. Where performance against targets is good, the health center or district hospital receives additional funds for service delivery (including salary top-ups). [51]

The EDPRS process has resulted in a review of the health care strategy, and will lead to a mid-term review of the HSSP once the EDPRS is finalized. This will ensure alignment with the EDPRS[52] and recent institutional and policy reforms.

In 2004, the Ministry of Health also developed a *Human Resources for Health Strategic Plan, 2006-2010*.[53] This plan contained strategies to address weaknesses in human resource planning, education and training, recruitment, retention and redistribution of staff, and management and performance. As noted above, it supported the idea of performance-based incentives, including soft loans and salary top ups through the contractual approach. Implementation of the plan has begun and there have been some successes, notably in terms of creating incentives for a better geographic distribution of health workers. However, the strategic plan was not costed, and subsequent negotiations with donors to create a basket fund to implement it were not successful.

Impacts. As discussed earlier, Rwanda's health outcome indicators are showing signs of improvement, with the 2005 Demographic and Health Survey showing significant falls in infant, child and maternal mortality. There are also positive trends in terms of the indicators chosen to measure progress against the 7 goals of the HSSP.[54] The staffing of rural health centers has improved, with the proportion of nurses in rural areas increasing from 20 to 56 percent as a result of decentralization of responsibility for staffing and increased resources from the Global Fund and the performance contracting approach. Membership of "mutuals" has increased from 7 percent in 2003 to 44 percent in 2005 and around 65 percent in 2006 through a combination of promotion, subsidies for the poorest, and compulsion.[55] This, combined with increased quality of care (performance contracting, human resources), has led to improved health facility utilization rates.[56] Vaccination rates remain high (in the range of 85-90 percent).

c. Planning and budgeting in health sector

Planning and budgeting in the health sector has generally been seen as strong relative to other sectors (with the exception of education). Main strengths include decentralization, the integration of planning and budgeting, and the engagement of budget support donors. Key challenges include that of donor coordination and of capacity.

The health sector is at the forefront of Rwanda's ***decentralization*** process. Health care delivery has long been managed through health districts. Until 2006, these were deconcentrated entities under the responsibility of MINISANTE. From 2006, they have been absorbed into the 30 newly devolved district administrations. In the 2006 budget, around 40 percent of government health resources were allocated to districts. However, to some extent this fiscal decentralization is illusory. For example, although health salaries appear under district budget headings (not under MINISANTE), they are disbursed direct to health centers. Performance based contracts appear under district budget headings but are managed centrally by MINISANTE.

Health sector ***budgeting*** has significantly improved in recent years. Health sector MTEFs and budget proposals are seen by MINECOFIN as best practice. A new MTEF and program structure was introduced for the 2007 budget, which presents the budget in terms of HSSP objectives. However, some suggest that this makes analysis of spending by level of care difficult, and confuses institutional accountability for budget programs.[57] Changing budget classifications have made analysis of health expenditure trends almost impossible.[58]

Budget support donors have significant influence over government expenditure on health. They have put pressure on MINECOFIN and MINISANTE to increase health budgets (particularly for primary health) and on the IMF to accommodate these increases. The scaling up of recurrent health expenditure using innovative approaches can be seen as a "success story" for budget support. The World Bank has had significant influence over health strategies and budgets since the introduction of the PRSC in 2004/5. This has led to a large increase in expenditure, particularly on primary health, and has seen an expansion of innovative solutions such as community health insurance and performance based contracting.

The health sector is characterized by the existence of numerous short term, uncoordinated and unaligned donor funded projects, as highlighted in the 2005 donor mapping study conducted by MINISANTE. This greatly complicates the planning and budgeting process – whilst planning (including financing strategies) includes all public spending, budgeting decisions only involve the 26 percent of resources under direct government control. The projects also make heavy demands on limited MINISANTE planning capacity.

Donor coordination has improved to some degree in recent years. The health cluster (Health Sector Coordination Group - HSCG) has become active, including through a number of technical working groups under the HSCG.[59] Several key project donors (notably the Global Fund) have increasingly integrated their projects into the mainstream health system, by providing infrastructure, equipment and personnel for health centers that are "fungible" in that they can be used for mainstream health activities at a decentralized level. This has enabled and accompanied the expansion of Government spending on primary healthcare, although there are serious concerns about sustainability.

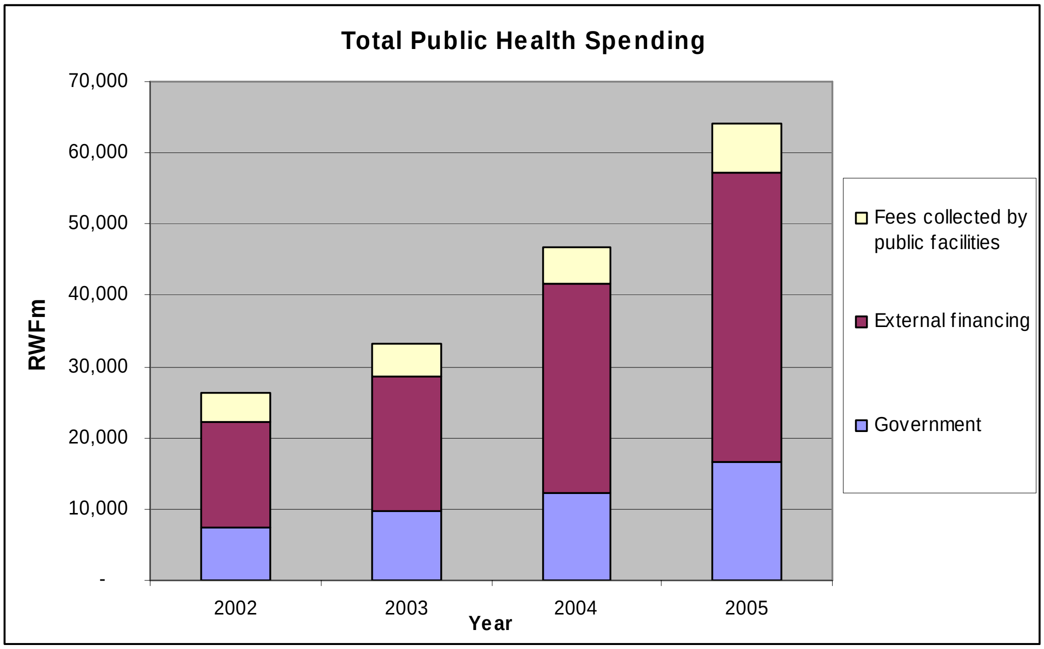
However, progress towards a SWAp (the stated ambition of Government and some partners) is slow. The main building blocks are in place, but the combination of limited Government capacity and insufficient donor willingness to change is preventing progress.[60]

The reduction of the staffing of MINISANTE in 2006 (to 30 posts for the whole core Ministry of Health, of which 20-25 are filled) has had a very negative impact on capacity. Much of the health planning and financing work achieved in recent years has been conducted by temporary consultants. The Ministry, together with HIDA (the Human Resources and Institutional Capacity Development Agency), are developing a strategy to reverse the reduction in staffing and create sustainable local capacity. It is not yet clear whether the new districts have sufficient health planning capacity.

d. Trends in Health Spending

In 2002, Rwanda's public health expenditure was very low by regional and international standards. The focus of expenditure was on secondary and tertiary care. Primary health facilities received little or no funding from Government and had very scarce human resources and equipment. Public health expenditure increased rapidly in the period from 2002, growing at an average annual rate of 35 percent from 2002-5. The table below shows that external financing (donor funded projects) account for most public health spending (63 percent in 2005) and most of the increase in spending. However, although resulting services are delivered from public sector facilities, most of these projects are not implemented through government systems and are not effectively under the government's control.[61] The projects result in severe geographical inequalities, and are not aligned with the government's strategy. In 2005, 55 percent of external aid, or 39 percent of total public expenditure on health was in the form of donor HIV/AIDS projects, despite a prevalence rate of only 3.1 percent.[62]

	Total public health spending (RWFm)			
	2002	**2003**	**2004**	**2005**
Government	7,404	9,693	12,263	16,682
External financing	14,789	18,845	29,433	40,672
Fees collected by public facilities	4,017	4,585	5,033	6,834
Total	**26,210**	**33,123**	**46,729**	**64,188**
As % GDP	3.2%	3.7%	4.4%	5.4%
Source: Health Public Expenditure Review (2006)				



Varying definitions of total government health expenditure, together with changes in classification, complicate the analysis of trends. Taking one narrow definition of government health spending (recurrent allocations to MINISANTE and to local governments for health programs), government health expenditure increased by an average of 21 percent in real terms on an annual basis from 2002-7. As shown in the table below, this narrow definition of recurrent budget allocations increased from 0.55 percent of GDP in 2001 to 1.42 percent in 2007.

	Recurrent budget allocations to health						
	2001	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
MINISANTE & local govt (RWFm)	4,147	5,438	7,616	8,213	13,450	18,450	21,170
MINISANTE & local govt (RWFm) Constant 2001 prices	4,147	5,438	7,006	6,746	10,315	12,994	14,199
as % total recurrent budget	4.6%	4.3%	5.0%	4.6%	6.3%	7.2%	7.4%
as % GDP	0.55%	0.66%	0.84%	0.78%	1.12%	1.36%	1.42%
Source: Estimates based on budget documents, IMF documents, Public Expenditure Review (2006)							

Budget execution fluctuated between 83-93 percent over 2002-5 (see table below). Before 2006, there were significant problems in budget execution caused by uncertain availability of funds from MINECOFIN. MINISANTE officials report that this was largely due to the previous inefficient treasury management system. Since the reform of treasury management in 2006 (moving towards a single treasury account through the introduction of zero-balance holding accounts for ministries, and closing unnecessary accounts – supported by IMF AFRITAC), this problem has been resolved.

	Budget execution (health sector)			
	2002	2003	2004	2005
Allocation (RWFm)	8,896	11,539	13,251	19,690
Execution (RWFm)	7,404	9,693	12,263	16,682
Execution rate (%)	83.2%	84.0%	92.5%	84.7%
Source: Health Public Expenditure Review (2006)				

Trends in intra-sectoral allocations are particularly difficult to analyze, as a result of shifting budget classifications. However, some clear trends can be highlighted. In 2002, most government health expenditure was on secondary and tertiary levels of care (particularly central hospitals). Health centers received minimal government support, relying on user fees and donor project support. Since 2003, primary healthcare has however increased its share, with increased funds going to performance based contracting schemes, rural health workers' salaries, and promoting community based health insurance schemes ("mutuals"). Poor execution of primary healthcare programs and over-expenditure on tertiary health programs in 2005 were flagged by budget support donors as a major concern. 2006 budget execution is reported to have been better.

e. Long-Term Fiscal Trade-Offs Involving the Health Sector

Although progress has been made towards the MDGs, Rwanda is at risk of failing to meet the targets.[63] The HSSP contains a financing framework with constrained and unconstrained (showing the resources needed to meet the MDGs) scenarios. This was based on the World Bank's Marginal Budgeting for Bottlenecks (MBB) tool.[64]

The costing of the EDPRS health strategy involved the development of three scenarios, based on the UNDP Needs Assessment tool. Again, this tool links the financing framework to the MDGs, but is less sophisticated than the MBB tool. The MINISANTE planning department is attempting to ensure capacity transfer so that the MBB model can be used in future. However, the effective use of either costing model requires improved data availability (including from the forthcoming 2006 National Health Accounts).

The work on the EDPRS health strategy has involved the development of 3 costing scenarios – unconstrained ($37.3 per capita per year), medium ($18.4 per capita per year) and constrained (the current level of $12.8 per capita per year). The latter identifies high impact (in terms of poverty) interventions. Strategic priorities continue to be boosting financial access to health services, particularly through community based health insurance (mutuals) and performance based transfers to health centers.

The EDPRS costing scenarios are broadly consistent with the projections made by the Government's paper presented to the Tunis High Level Forum meeting in June 2006. This projected that $22 per capita additional spending (on top of the current $12.8) would be needed to meet the MDGs. A more limited package of $10 additional per capita, covering only Steps 1-

5 in the chart below (which exclude Step 6--further roll-out of Anti-Retroviral treatment for AIDS), would achieve between two thirds and three quarters of the progress needed towards the MDGs. However, the paper recognizes the limited scope for further increases in health's share of the national budget. Its assumptions about health financing imply only a $2 per capita increase in health spending by 2015. The paper therefore concludes that the focus should be on making better use of the existing resources available – in particular, by improving the management of donor support.

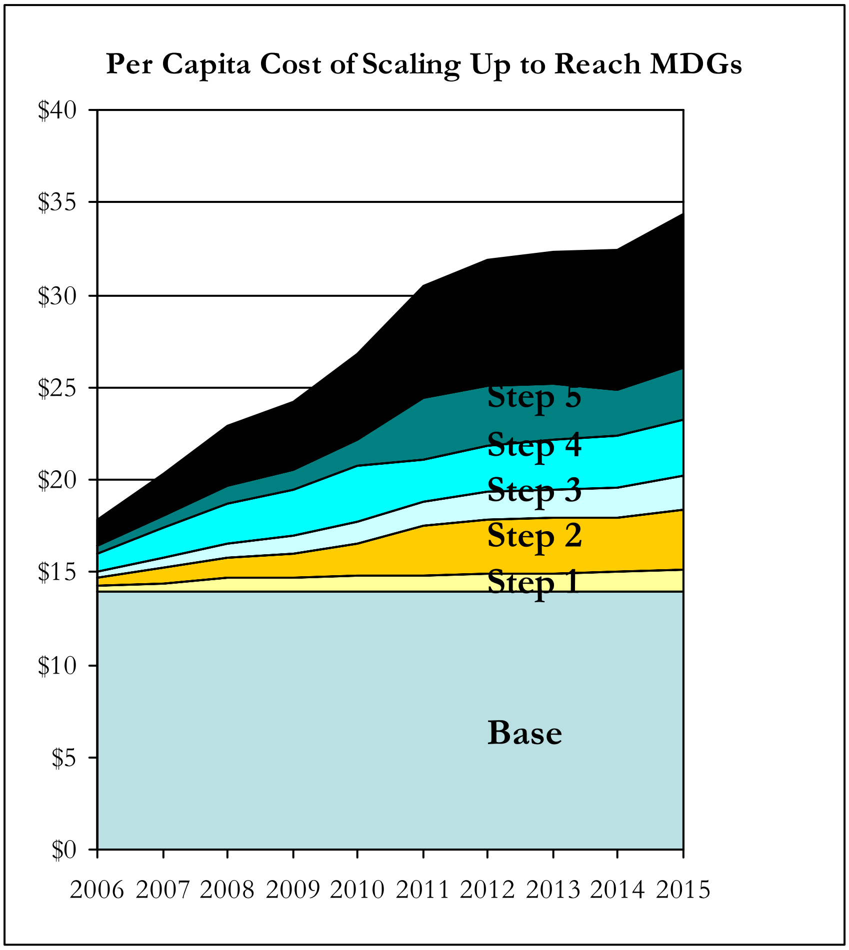
These conclusions reinforce the message of the HSSP that the challenges of scaling up health expenditure for the MDGs in Rwanda are not just about additional resources, but about the quality of existing resources.

A variety of factors are likely to influence the magnitude of additional resources channeled to the health sector, but it is likely that difficult choices on trade-offs will persist:

- The focus of additional expenditure under the EDPRS is on capital expenditure, particularly for infrastructure. The health sector is unlikely to benefit from a significant scaling up from Government resources. The emphasis is expected to be on better managing existing resources (particularly donor project funds).
- Of the current policy options for dealing with the macroeconomic implications of scaling up, a restructuring of the budget away from domestic spending and towards import related spending is being actively explored. Areas such as health which are largely domestic expenditure driven are therefore likely to benefit little from further scaling up.
- However, pressure from the budget support donors (including the World Bank) will oppose these factors. For example, the World Bank's PRSC conditions include a continued substantial increase in the public expenditure share of the health sector (to 10 percent in 2007 and 15 percent in 2015, in line with the Abuja Declaration).

The IMF has not been involved significantly in these discussions, other than to express concern (as discussed earlier) about avoiding excessive salary increases. However, the IMF macro assessments have not so far been linked to any analysis of the longer term fiscal implications of scaling-up health sector activities, including the potential fiscal contingencies if donor support for activities with major recurrent cost implications were to be withdrawn.[65]

Chart 4. Estimated Costs of Reaching the MDGs
(US dollars, per head)



Source: Scaling Up to Reach the MDGs in Rwanda. Presentation to the High level Forum on the Health MDGs by Dr Jean-Damascene Ntwawuliryayo, Minister of Health, Republic of Rwanda, Tunis, June 2006.

IV. Lessons

The case study suggests lessons for the IMF, the Government of Rwanda, and donors.

For the IMF

1. *The IMF should explore in more depth the macroeconomic consequences of alternative scenarios for aid and public expenditures. For most of the period reviewed, it tended to respond to changes in aid, rather than taking the lead in exploring the potential macroeconomic implications of more expansionary, but still feasible, options.* The medium-term projections for aid underlying Rwanda's original program were too pessimistic and there was insufficient exploration of alternative scenarios. Indeed, early in the period the IMF appeared to discourage higher aid inflows by stressing potential macroeconomic disadvantages, but without any systematic analysis of supply-side consequences that would have been necessary for such a judgment. Subsequent programs eventually adapted to changing circumstances, both in terms of the degree of optimism about expected aid flows and the flexibility with which the fiscal programs used the additional aid. Even in this latter period, however, the IMF was largely just reacting after the fact to decisions taken by the donor community. Of course, ambiguity by many donors as to their intentions – stemming in large part from regional geo-political tensions – greatly complicated the IMF's task. Until very recently, however, it did not play a significant role in exploring ex ante the macroeconomic consequences of scaled up aid. This was partly because the necessary information to undertake such analysis (e.g., prioritized sector-specific plans for scaling-up expenditures) was not available for all key sectors (although the plans for the health sector were better developed than in most countries).

2. *The IMF should be more explicit about the rationale and analysis underlying the path it recommends for the fiscal deficit and spending. Greater humility is needed in pronouncing on the appropriate fiscal path when good quality expenditure analysis is lacking.* Following debt relief, a wider variety of fiscal paths would have been potentially feasible, depending on the effectiveness with which the resources were used. But to explore these options requires different types of analysis and frameworks that incorporate longer-term supply-side considerations, linked to government choices on the level and composition of expenditures. The IMF does not have the sector-specific expertise to generate the necessary inputs, but needs to find ways of integrating such inputs into its macroeconomic assessments if it is to continue playing a central role in advising countries (and donors) on the macroeconomic challenges of scaling up. Without such analysis, the IMF risks unduly narrowing the policy space on possible fiscal options.

3. *Greater clarity is needed about the "signal" the IMF is sending about any particular level of aid.* Interviews of IMF staff, government officials and donor representatives indicated a striking difference in perceptions of what message the IMF was sending about the desirability of additional aid, especially during the period through 2003. IMF staff all said that, while they had been concerned not to build the program around over-optimistic assumptions of aid, the IMF had sent no signal about what aid levels *should* be. In

contrast, most government officials and many donors said that they had interpreted the IMF position as one of discouraging substantially higher aid inflows because of the potential macroeconomic risks and concerns about Rwanda's capacity to absorb such aid.

There are four broad alternatives for the IMF in its analysis and signaling on aid and the IMF needs to be much clearer about which it is pursuing:

a) The IMF would take the level of aid as given, based on a survey of existing donor intentions with the government taking the lead in this survey. The IMF would derive a macroeconomic framework consistent with this aid level and objectives of macro stability. But it would state explicitly that it took no view whatsoever on the compatibility of this framework and level of aid with any objectives related to poverty-reduction or development, which were beyond its expertise.
b) The IMF would take the level of aid as given and prepare the macro framework as in the first case. Based on sector-level inputs from others, it would also give its judgment if there are strong reasons to doubt that this framework were compatible with achieving the MDGs.
c) The IMF would act as in option b. But it would also make an assessment, based on sector-level inputs of the likely effects of additional aid-financed expenditures, of whether there were any significant ***macroeconomic*** constraints on absorbing significantly more aid. This assessment could be in the form of an alternative scenario that analyzed the macro effects of a significant scaling-up of aid
d) Working with sector-level inputs (e.g., the World Bank and others), the IMF would devise a macroeconomic framework and estimates of aid requirements to achieve the MDGs. (There are significant problems with approaches built around estimating such financing "gaps", but this is an issue that goes beyond the scope of this case study. The main point is that the IMF should be clear about what it does, and does not, intend to do.)

Our recommended option is c. One obvious potential benchmark for anchoring the scaling up scenario would be to assume that donors' collectively meet their recent commitments on global aid flows (e.g., a doubling of aid to Africa by 2010 that was highlighted at the G8 Gleneagles Summit) and to analyze the implications if Rwanda were to maintain its present share of aid.

4. *Debt sustainability judgments leaned too heavily on a particular threshold indicator of potential debt distress (the debt/export ratio).* The key question is whether the analytical framework on debt sustainability used by the IMF was robust enough to say that a country like Rwanda, with enormous development needs, should turn down aid with up to a 50-percent grant element and be cautious about borrowing even when the grant element of loans was above this level. This is essentially a question of balancing risks (i.e., between foregoing potentially desirable expenditures versus encountering renewed debt problems in the long term) with very incomplete information. On balance, we think the framework ruled out some feasible policy options—where greater space should have been made for the authorities to consider and discuss the tradeoffs they were willing to accept. But it is unlikely that health expenditures (as opposed to spending on

infrastructure, etc.) were affected by this constraint, since available aid for the sector was almost exclusively on grant terms.

5. *Initially, the program design allowed too little "*ex ante*" flexibility in how macroeconomic policies would respond to short-term shocks to aid flows*. A design that leaned more in the direction of expenditure smoothing from the outset would have been justified-- given Rwanda's substantial external reserve and the fact that the degree of permanence of any such shock could always be reconsidered at the time of the six-monthly program reviews. But the IMF did shift subsequently in favor of greater fiscal flexibility. Especially since early 2005, there has been greater emphasis on cushioning expenditures from adverse shocks to aid and on allowing positive aid "surprises" to be spent.

6. *The IMF should pay greater attention to long-term fiscal contingency issues, including the potential consequences if aid financing of off-budget activities is disrupted.* This would also allow a better analytical contribution to issues concerning fiscal choices for the health sector rather than leaving the health sector to come up with a longer-term strategy with limited macro input and then responding in an ad hoc manner to particular elements of the strategy (e.g., for wages) at the relatively late stage of the annual budget.

7. *The Poverty and Social Impact Analysis (PSIA) exercise was a missed opportunity to explore broader policy options for the macroeconomic framework.* Some of the reasons were not the fault of the IMF, including significant problems with the process and technical aspects of the initial analysis. However, the IMF response was disproportionate and failed to take on board a series of legitimate issues raised by the PSIA and subsequent discussions. These issues could and should have been built on rather than dismissed.

For donors

1. *Predictability of aid and long-term commitments is critical for effective planning of a scaling-up of health spending.* There have been some improvements in the predictability of aid recently, especially for direct budget support as donors signal their commitments early in the annual budgetary process. However, much longer term assurance of levels of support are needed if Rwanda is to embark on a major expansion of health initiatives that have substantial recurrent cost implications and would be difficult to reverse. The shorter the timeframe of any aid commitments, the greater the fiscal risk, which will inevitably affect the incentives to undertake such an expansion. This is also true for rapidly growing "vertical" funds, even though the bulk of their operations are off-budget. Once started, donors have to be in for the long haul on such initiatives.

2. *The health sector still suffers from the existence of numerous short term, uncoordinated and unaligned donor funded projects*. This greatly complicates the planning and budgeting process and distorts decision-making on long-term budgetary choices. The multitude of projects also makes heavy demands on limited MINISANTE planning capacity.

3. *Budget support donors need to ensure coherence with health sector policy discussions and that they are not over-extending their policy influence.* There is for example a case to be made that they were pushing too hard on primary vs. tertiary spending, particularly

in the context of the level of donor financing to the primary sector. Similarly the interviews suggested the micromanagement of budget preparation, particularly by World Bank, has not been constructive.

4. *Despite rhetorical commitments, there are still significant issues around off-budget projects and alignment of aid more generally*. Project donors particularly need to do much more to support and comply with the recent government aid policy. Specific issues include project information being reported to Government in a timely manner and in a format compatible with national budget processes. The new data management system (the Donor Assistance Database), which is adapted to relating aid to the budget, will need to be supported and used by donors. However, while improving the level and nature of reporting is essential, donors need to move beyond this to using government systems more systematically. If it is not possible to use, for example, government procurement systems, or accounting and disbursement mechanisms, at least donors should move towards projects using the same rules or procedure as the government systems. Alignment can then occur will projects remain administered and managed by the donor (e.g., “shadow systems align”).[66]

For the Government of Rwanda:

1. *The definition of priority expenditure is too broad and needs to be refined if it is to continue to be a useful supplement to regular budgetary processes*. At present, it risks becoming meaningless as more and more programmes are added to the definition. It also fails to take into account intra-sectoral issues. For example, all health spending is defined as priority. But the donors also have a part to play in any revamping, to avoid the approach being one that lists donor, rather than government, priorities.

2. *The Government should ensure there is adequate capacity for budgeting and national priority setting* (i.e., by revisiting the massive staffing reductions in MINISANTE). Government and donors also need to rationalize and strengthen the health management information system, ensuring its fit to the new structure of local government.

Appendix 3

Documents Reviewed

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Stakeholders interviewed

Mr. Chris Adams, Lecturer, Center for the Study of African Economics, Oxford University, (peer reviewer of PSIA)

Mr. Jean Barbe, Head of Economics and Governance, European Commission, Rwanda

Ms. Angelique Bitahaninkindi, Project Officers, European Commission, Rwanda

Mr. Giles Bolton, former Head of Office, DFID Rwanda (2000-2002)

Ms. Jo Bourne, Senior Education Advisor, DFID Rwanda

Ms. Mailan Chiche, ODI Fellow, Budget Unit, Ministry of Finance and Economic Planning (ex. European Commission)

Mr. Vincent de Boer, CTB Technical Advisor, Development Planning Unit, Ministry of Finance and Economic Planning

Mr. Dick De Clerq, Conseiller Health, Belgian Embassy, Rwanda

Mr. Lars Engstrom, IMF resident representative, 2005-present

Ms. Kene Ezemenari, World Bank

Mr. Abdikarim Farah, IMF resident representative, 2002-2005

Mr. Pablo Gottret, World Bank

Ms. Ida Hakizinka, Permanent Secretary, Global Fund CCM Rwanda (ex. Economist, Planning Unit, Ministry of Finance and Economic Planning)

Dr. Andreas Kalk, Head of German Health Cooperation, Rwanda

Mr. Camille Karamaga, President, Kigali Free Zone Taskforce (ex. Director of Budget, Ministry of Finance and Economic Planning)

Mr. Vincent Karega, Minister of State in Charge of Industry and Investment Promotion (ex. Director of Planning, Ministry of Finance and Economic Planning)

Mr. Colin Kirk, Head of Office, DFID Rwanda Ms. Diana Kizza, ODI Fellow, Planning Department, Ministry of Health

Ms. Kristina Kostial, IMF Mission chief, 2005-2006

Mr. David Macrae, Head of Delegation, European Commission, Rwanda

Mr. John McKinnon, Independent consultant (lead consultant on Rwanda's PSIA and PRSP)

Members of the Health Sector Coordination Group

Mr. Kenneth Meyers, IMF mission chief, 2002-2004

Mr. Prosper Musafiri, Director of Macroeconomics, Ministry of Finance and Economic Planning (ex. Director of Budget)

Dr. Vianney Nizeyimana, Researcher, Treatment and Research of AIDS Centre (ex. Director of Planning, Ministry of Health)

Mr. Jean Jacques Nyirabutama, Director of External Finance, Ministry of Finance and Economic Planning

Mr. Duncan Overfield, Economic Advisor, DFID Rwanda

Mr. Mark Plant, Senior Advisor, Policy Development and Review Department, IMF

Mr. Fred Quarshie, Fiscal Advisor, Ministry of Finance and Economic Planning

Dr. Jean Francois Ruhashyankiko, Senior Economic Advisor to the Minister, Ministry of Finance and Economic Planning

Mr. Ernest Rwamucyo, Director-General for Development Planning, Ministry of Finance and Economic Planning

Dr. Claude Sekabaraga, Director of Planning, Ministry of Health

Ms. Agnes Soucat, World Bank

Mr. Simon Stevens, Economist, UK Treasury (ex. Economic Advisor, DFID Rwanda)

Mr. Nicolas Theopold, Consultant, Dalberg (ex. ODI Fellow, Planning Unit, Ministry of Health)

Mr. Bruno Versailles, DPhil Student, Oxford University (ex. ODI Fellow, Planning Unit, Ministry of Finance and Economic Planning)

Rwanda: Actual Outcomes	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	*04-06*	*07-08*
Growth and inflation	t_{-9}	t_{-8}	t_{-7}	t_{-6}	t_{-5}	t_{-4}	t_{-3}	t_{-2}	t_{-1}	t_0	t_1	t_2	t_3	t_4	t_0-t_2	t_3-t_4
Real GDP growth (percent)	35.2	12.7	13.8	8.9	7.6	6.0	6.7	9.4	0.9	4.0	6.0	3.0				
Inflation (percent; end-period)	38.4	8.7	16.6	-6.0	2.1	5.8	-0.2	6.2	7.7	10.2	5.6	5.0				
External Targets																
Grants (US$ mn)	301	264	253	244	246	278	234	212	234	339	452	346			1136	
Public foreign borrowing (US$ mn)	64	54	85	162	126	79	129	92	70	121	85	64			270	
Amortization (US$ mn)	-25	-21	-26	-25	-43	-38	-21	-38	-27	-43	-45	-10			-98	
Total net aid flows (US$ mn)	340	297	312	381	329	320	342	266	276	417	492	399			1308	
Current account balance before official transfers (% of GDP)	-19.1	-19.3	-17.5	-17.0	-16.7	-16.3	-15.9	-16.6	-19.2	-18.2	-19.4	-21.4				
Current account balance after official transfers (% of GDP)	-3.1	-6.7	-9.5	-9.6	-7.6	-5.0	-5.9	-6.7	-7.8	-3.0	-3.1	-10.8				
Fiscal targets (% of GDP)																
Official Transfers	16.0	12.6	8.0	7.4	9.1	11.3	10.0	9.9	11.4	15.2	16.3	10.6				
Total Revenue Excluding Grants	6.8	9.3	10.4	10.6	9.9	9.7	11.4	12.2	13.5	13.9	15.1	14.1				
Total Expenditures	20.5	22.5	19.6	18.9	19.6	18.7	21.0	21.2	23.9	26.1	28.5	28.1				
Overall balance, before grants	-13.7	-13.2	-9.2	-8.3	-9.7	-8.9	-9.5	-8.9	-10.3	-12.1	-13.4	-13.9				
Overall balance, after grants	-2.4	-5.8	-2.5	-3.0	-4.0	0.7	-1.3	-1.7	-2.3	-0.2	0.7	-0.7				
External financing, incl. debt relief	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0				
Domestic fiscal balance	-4.5	-2.9	-0.3	-1.3	-3.8	-2.6	-2.7	-4.2	-5.5	-5.5	-5.6	-7.4				
Gross Reserves (in months of imports of goods and services)	3.3	2.7	4.0	4.6	4.7	5.4	6.0	6.3	5.0	5.7	6.2	4.9				

Rwanda: Original program (July 2002)	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	*04-06*	*07-08*
Growth and inflation																
Real GDP growth (percent)	35.2	12.7	13.8	8.9	7.6	6.0	6.7	7.3	6.1	6.2						
Inflation (percent; end-period)	38.4	8.7	16.6	-6.0	2.1	5.8	-0.2	3.0	3.0	3.0						
External Targets																
Grants (US$ mn)	301	264	263	244	251	268	236	246	250	233					233	
Public foreign borrowing (US$ mn)	64	54	85	162	126	92	126	109	68	61					61	
Amortization (US$ mn)	-25	-21	-26	-25	-44	-38	-23	-33	-32	-36					-36	
Total net aid flows (US$ mn)	340	297	312	381	329	320	341	323	287	257					257	
Current account balance before official transfers (% of GDP)	-19.0	-19.3	-17.5	-17.0	-16.7	-16.3	-16.4	-17.0	-15.7	-13.5						
Current account balance after official transfers (% of GDP)	-3.0	-6.7	-9.5	-9.6	-7.4	-5.0	-6.5	-11.3	-11.5	-10.3						
Fiscal targets (% of GDP)																
Official Transfers	16.0	12.6	8.0	7.4	9.3	11.3	9.9	5.7	4.2	3.2						
Total Revenue Excluding Grants	6.8	9.3	10.4	10.6	9.9	9.7	11.4	12.2	12.7	12.8						
Total Expenditures	20.5	22.5	19.6	18.9	19.6	18.7	21.0	22.1	22.1	20.8						
Overall balance, before grants	-13.7	-13.2	-9.2	-8.3	-9.7	-8.9	-9.5	-9.9	-9.4	-8.0						
Overall balance, after grants	-2.4	-5.8	-2.5	-3.0	-3.8	0.1	-1.1	-1.1	-0.6	0.1						
External financing, incl. debt relief																
Domestic fiscal balance	-4.5	-2.9	-0.3	-1.3	-3.8	-2.6	-2.7	-3.3	-2.8	-1.3						
Gross Reserves (in months of imports of goods and services)	3.3	2.7	4.0	4.6	4.7	5.2	5.7	5.9	6.2	6.2						

Rwanda: First Review (May 2003)	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	*04-06*	*07-08*
Growth and inflation																
Real GDP growth (percent)	35.2	12.7	13.8	8.9	7.6	6.0	6.7	9.4	3.2	6.0	6.0					
Inflation (percent; end-period)	38.4	8.7	16.6	-6.0	2.1	5.8	-0.2	6.2	3.0	3.0	3.0					
External Targets																
Grants (US$ mn)	301	264	253	244	246	278	234	237	305	255	269				524	
Public foreign borrowing (US$ mn)	64	54	85	162	126	79	129	99	113	65	28				93	
Amortization (US$ mn)	-25	-21	-26	-25	-43	-38	-21	-36	-23	-35	-41				-76	
Total net aid flows (US$ mn)	340	297	312	381	329	320	341	299	396	285	256				542	
Current account balance before official transfers (% of GDP)	-19.1	-19.3	-17.5	-17.0	-16.7	-16.3	-15.9	-17.2	-18.7	-17.4	-16.1					
Current account balance after official transfers (% of GDP)	-3.1	-6.7	-9.5	-9.6	-7.6	-5.0	-5.9	-7.3	-11.3	-12.3	-11.3					
Fiscal targets (% of GDP)																
Official Transfers	16.0	12.6	8.0	7.4	9.1	11.3	10.0	9.9	7.4	5.1	4.8					
Total Revenue Excluding Grants	6.8	9.3	10.4	10.6	9.9	9.7	11.4	12.2	13.4	13.6	13.7					
Total Expenditures	20.5	22.5	19.6	18.9	19.6	18.7	21.0	23.2	24.7	21.9	21.7					
Overall balance, before grants	-13.7	-13.2	-9.2	-8.3	-9.7	-8.9	-9.5	-11.0	-11.3	-8.2	-8.0					
Overall balance, after grants	-2.4	-5.8	-2.5	-3.0	-4.0	0.7	-1.3	-2.4	0.9	0.7	1.2					
External financing, incl. debt relief																
Domestic fiscal balance	-4.5	-2.9	-0.3	-1.3	-3.8	-2.6	-2.7	-4.2	-4.4	-1.1	-0.5					
Gross Reserves (in months of imports of goods and services)	3.3	2.7	4.0	4.6	4.7	5.4	5.8	6.3	7.4	6.9	6.0					

Rwanda: Second and Third Reviews (May 2004)	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	*04-06*	*07-08*
Growth and inflation																
Real GDP growth (percent)	35	13	14	9	8	6	6.7	9.4	0.9	6.0	6.0	6.0				
Inflation (percent; end-period)	38	9	17	-6	2	6	-0.2	6.2	7.7	5.0	4.0	4.0				
External Targets																
Grants (US$ mn)	301	264	253	244	246	278	234	212	234	309	276	292			876	
Public foreign borrowing (US$ mn)	64	54	85	162	126	79	129	91	71	108	120	96			324	
Amortization (US$ mn)	-25	-21	-26	-25	-43	-38	-21	-36	-23	-35	-42	-47			-124	
Total net aid flows (US$ mn)	340	297	312	381	329	320	342	266	282	382	354	340			1077	
Current account balance before official transfers (% of GDP)	-19	-19	-18	-17	-17	-16	-15.9	-16.6	-19.8	-21.4	-20.8	-20.1				
Current account balance after official transfers (% of GDP)	-3	-7	-10	-10	-8	-5	-5.9	-6.7	-8.4	-6.9	-8.2	-9.4				
Fiscal targets (% of GDP)																
Official Transfers	16	13	8	7	9	11	10.0	9.9	11.4	14.5	12.6	10.7				
Total Revenue Excluding Grants	7	9	10	11	10	10	11.4	12.2	13.5	13.5	13.5	13.6				
Total Expenditures	21	23	20	19	20	19	21.0	21.3	24.1	28.3	26.1	25.1				
Overall balance, before grants	-14	-13	-9	-8	-10	-9	-9.5	-9.1	-10.5	-14.8	-12.5	-11.5				
Overall balance, after grants	-2	-6	-3	-3	-4	1	-1.3	-1.9	-2.5	-2.2	-0.7	-1.0				
External financing, incl. debt relief	0	0	0	0	0	0	0.0	0.0	0.0	0.0	0.0	0.0				
Domestic fiscal balance	-5	-3	0	-1	-4	-3	-2.7	-4.2	-5.5	-7.8	-5.2	-4.0				
Gross Reserves (in months of imports of goods and services)	3	3	4	5	5	5	6.0	6.3	5.0	4.6	5.2	5.5				

Rwanda: Fourth Review (March 2005)	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	*04-06*	*07-08*
Growth and inflation																
Real GDP growth (percent)	35	13	14	9	8	6	7	9.4	0.9	4.0	4.0	4.3	4.5			
Inflation (percent; end-period)	38	9	17	-6	2	6	0	6.2	7.7	10.2	6.0	4.0	4.0			
External Targets																
Grants (US$ mn)	301	264	253	244	246	278	234	212	234	339	356	389	385		1084	
Public foreign borrowing (US$ mn)	64	54	85	162	126	79	129	92	70	121	88	108	108		318	
Amortization (US$ mn)	-25	-21	-26	-25	-43	-38	-21	-38	-27	-43	-49	-54	-57		-145	
Total net aid flows (US$ mn)	340	297	312	381	329	320	342	266	276	417	396	443	437		1256	
Current account balance before official transfers (% of GDP)	-19	-19	-18	-17	-17	-16	-16	-16.6	-19.2	-18.1	-21.9	-20.4	-19.4			
Current account balance after official transfers (% of GDP)	-3	-7	-10	-10	-8	-5	-6	-6.7	-7.8	-3.0	-9.0	-7.0	-7.2			
Fiscal targets (% of GDP)																
Official Transfers	16	13	8	7	9	11	10	9.9	11.4	15.1	12.9	13.4	12.2			
Total Revenue Excluding Grants	7	9	10	11	10	10	11	12.2	13.5	13.9	14.0	14.1	14.3			
Total Expenditures	21	23	20	19	20	19	21	21.2	23.9	26.1	26.7	27.7	27.3			
Overall balance, before grants	-14	-13	-9	-8	-10	-9	-10	-8.9	-10.3	-12.1	-12.7	-13.6	-13.0			
Overall balance, after grants	-2	-6	-3	-3	-4	1	-1	-1.7	-2.3	-0.2	-0.9	-1.5	-1.8			
External financing, incl. debt relief																
Domestic fiscal balance	-5	-3	0	-1	-4	-3	-3	-4.2	-5.5	-5.5	-5.3	-6.4	-5.9			
Gross Reserves (in months of imports of goods and services)	3	3	4	5	5	5	6	6.3	5.0	5.8	4.8	4.8	4.8			

Rwanda: Fifth Review (August 2005)	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	*04-06*	*07-08*
Growth and inflation																
Real GDP growth (percent)	35	13	14	9	8	6	7	9.4	0.9	4.0	4.0	4.3	4.5			
Inflation (percent; end-period)	38	9	17	-6	2	6	0	6.2	7.7	10.2	6.0	4.0	4.0			
External Targets																
Grants (US$ mn)	301	264	253	244	246	278	234	212	234	339	381	435	430		1154	
Public foreign borrowing (US$ mn)	64	54	85	162	126	79	129	92	70	121	88	108	108		317	
Amortization (US$ mn)	-25	-21	-26	-25	-43	-38	-21	-38	-27	-43	-48	-54	-56		-144	
Total net aid flows (US$ mn)	340	297	312	381	329	320	342	266	276	417	421	489	482		1327	
Current account balance before official transfers (% of GDP)	-19	-19	-18	-17	-17	-16	-16	-16.6	-19.2	-18.1	-22.0	-20.8	-20.2			
Current account balance after official transfers (% of GDP)	-3	-7	-10	-10	-8	-5	-6	-6.7	-7.8	-3.0	-9.0	-7.4	-7.9			
Fiscal targets (% of GDP)																
Official Transfers	16	13	8	7	9	11	10	9.9	11.4	15.1	13.0	13.4	12.3			
Total Revenue Excluding Grants	7	9	10	11	10	10	11	12.2	13.5	13.9	14.6	14.1	14.3			
Total Expenditures	21	23	20	19	20	19	21	21.2	23.9	26.1	27.0	27.7	27.3			
Overall balance, before grants	-14	-13	-9	-8	-10	-9	-10	-8.9	-10.3	-12.2	-12.4	-13.5	-13.0			
Overall balance, after grants	-2	-6	-3	-3	-4	1	-1	-1.7	-2.3	-0.2	-0.5	-1.4	-1.8			
External financing, incl. debt relief																
Domestic fiscal balance	-5	-3	0	-1	-4	-3	-3	-4.2	-5.5	-5.6	-5.0	-6.3	-5.9			
Gross Reserves (in months of imports of goods and services)	3	3	4	5	5	5	6	6.3	5.0	5.8	4.9	4.6	4.4			

Rwanda: Sixth Review/New PRGF Program (May 2006)	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	*04-06*	*07-08*
Growth and inflation																
Real GDP growth (percent)	35	13	14	9	8	6	7	9.4	0.9	4.0	6.0	3.0	4.3	4.5		
Inflation (percent; end-period)	38	9	17	-6	2	6	0	6.2	7.7	10.2	5.6	5.0	5.0	5.0		
External Targets																
Grants (US$ mn)	301	264	253	244	246	278	234	212	234	339	452	346	338	334	1136	672
Public foreign borrowing (US$ mn)	64	54	85	162	126	79	129	92	70	121	85	64	131	129	270	260
Amortization (US$ mn)	-25	-21	-26	-25	-43	-38	-21	-38	-27	-43	-45	-10	-10	-9	-98	-19
Total net aid flows (US$ mn)	340	297	312	381	329	320	342	266	276	417	492	399	460	453	1308	913
Current account balance before official transfers (% of GDP)	-19	-19	-18	-17	-17	-16	-16	-16.6	-19.2	-18.2	-19.4	-21.4	-19.2	-18.2		
Current account balance after official transfers (% of GDP)	-3	-7	-10	-10	-8	-5	-6	-6.7	-7.8	-3.0	-3.1	-10.8	-10.0	-10.5		
Fiscal targets (% of GDP)																
Official Transfers	16	13	8	7	9	11	10	9.9	11.4	15.2	16.3	10.6	9.2	7.7		
Total Revenue Excluding Grants	7	9	10	11	10	10	11	12.2	13.5	13.9	15.1	14.1	14.3	14.5		
Total Expenditures	21	23	20	19	20	19	21	21.2	23.9	26.1	28.5	28.1	27.5	27.5		
Overall balance, before grants	-14	-13	-9	-8	-10	-9	-10	-8.9	-10.3	-12.1	-13.4	-13.9	-13.3	-13.0		
Overall balance, after grants	-2	-6	-3	-3	-4	1	-1	-1.7	-2.3	-0.2	0.7	-0.7	-3.6	-4.1		
External financing, incl. debt relief																
Domestic fiscal balance	-5	-3	0	-1	-4	-3	-3	-4.2	-5.5	-5.5	-5.6	-7.4	-6.9	-6.6		
Gross Reserves (in months of imports of goods and services)	3	3	4	5	5	5	6	6.3	5.0	5.7	6.2	4.9	4.8	4.7		

Endnotes

[1] Preliminary Poverty Update Report, Household Living Conditions Survey, 2005/2006.
[2] The aid flows shown in Table 1 and Appendix Table 1 are taken from IMF documents and reflect the data recorded in the balance of payments. This data series is the main focus of discussion in this paper, since it is the one used in IMF programs. Aid flows recorded in OECD DAC statistics are significantly higher.
[3] See Appendix 3 for a list of documents reviewed and persons interviewed.
[4] Interviews with MINECOFIN officials.
[5] Rwanda had qualified for interim debt relief when it reached the "decision point" under the Enhanced HIPC Initiative in December 2000, but continuation of an IMF arrangement in good standing was one of the conditions for such relief and for progressing to the "completion point."
[6] In the event, financing provided under the new PRGF was very small (only SDR 4 million—equivalent to about $5½ million over the initial 3-year period), in part because IMF financing was regarded as insufficiently "concessional" in light of the debt sustainability concerns.
[7] MINECOFIN officials acknowledge that several of the issues raised in the IMF's rejection of the PRSP costing scenarios (Dutch Disease, domestic demand impact etc.) were not previously discussed. The PSIA was therefore seen as an opportunity for government to develop better and more realistic macroeconomic scenarios.
[8] The UK Department of International Development (DFID) supported demonstration studies in six countries to provide ex ante analysis of the likely poverty and social impact of particular policies. The Rwanda PSIA was one of these studies.
[9] See, for example, paras 35-36 and para 52 of the Staff Report for the 2004 Article IV Consultation, November 30 2004.
[10] However, it is not clear that the PSIA itself was a direct influence in this. Other factors have more explanatory power, including the change in mission chief, shifts in high level IMF policy, high level lobbying by Dr. Kaberuka, and pressure from the World Bank and other agencies.
[11] The slippages in implementation in 2003 led to delays in completing reviews and the second and third reviews were eventually combined.
[12] SDR 8 million or about $11-½ million over the 3-year period.
[13] The fact that Rwanda had to apply for large additional "topping up" of debt relief when it reached the completion point under the Enhanced HIPC Initiative also influenced the reluctance to sanction new borrowing.
[14] The main fiscal target was the domestic fiscal balance, defined as revenues (excluding grants) minus current expenditures(excluding external interest) minus domestically-financed capital expenditures and net lending.
[15] Original program targets were often revised at the time of program reviews; see Appendix Table 1 for details.
[16] Estimated for 2006, based on partial-year data (from IMF staff report for fourth program review).
[17] Change (in percentage points of GDP) between t_{-1} and t_{+2}, where t_0 is the year in which the original program was approved.
[18] The issue is highlighted in Tony Killick 2005 review of GBS donors relationship with Rwanda.
http://www.devpartners.gov.rw/docs/Events/Workshops/Paris%20Declaration%20Workshop/index.php?dir=Day1%2FBackground_Docs%2F&download=Promoting_a_3rd_Phase_in_Relations.pdf
[19] Although commitments data has generally proved to be a relatively poor guide to actual dollar disbursements, the comparison here is in terms of trend rates of growth.
[20] With few exceptions, IMF-supported programs typically define borrowing on concessional terms as having a minimum grant element of 35 percent. (The only other countries we are aware of where the limit is set at 50 percent are Niger and Guyana.) The definition is important because IMF programs typically have strict ceilings (which are often zero, as in the case of Rwanda) on borrowing on non-concessional terms.
[21] Particularly during the preparation and Board presentation of the first Poverty Reduction Support Credit in 2004. The Fund insisted that Rwanda not exceed the $20m limit on borrowing implied by the HIPC framework.
[22] The World Bank and Asian Development Bank's shift to grants has led to a decrease in the total amount available to Rwanda (for example, the amount disbursed through the PRSC/PRSG has steadily fallen, from $65 million in 2004/05 to $50 million in 2007), although other factors (governance, procurement, poor performance of existing projects) have also influenced the decline.
[23] Rwanda probably had a greater degree of existing analysis of some supply-side issues (e.g., Mellor et al, 1990) than many other similar IMF programs, and some of those interviewed thought the results of this analysis was dismissed perhaps a little too easily. IMF staff emphasized that their caution about export prospects was not just based on the volatility of export prices. They had drawn on extensive discussions with those involved in the

rehabilitation of the tea and coffee sectors which had suggested that raising volumes and competitiveness would be a difficult process, especially for the tea sector.

[24] When the new DSA framework was introduced, the IMF Board decided upon more conservative thresholds (including the 150 percent level) than those originally proposed by the IMF staff—in part because they did not want to create an inconsistency with the enhanced HIPC Initiative framework. See IMF and World Bank (2005).

[25] In the case of the World Bank's IDA allocations, the tradeoffs between a higher grant element and the volume of financing have been made explicit. IDA-only countries classified as at high risk of debt distress receive 100 percent grant financing from IDA while countries classified as at moderate risk receive 50 percent grant financing. The volume of grants provided is reduced by 20 percent (i.e., $100 of concessional loans translates into $80 in grants.) However, there is a provision for reallocations of any unused IDA financing to countries with good performance, so the total volume of IDA aid to Rwanda would not necessarily fall over the medium term.

[26] IMF staff said they were aware of only one project (in the energy sector) that had been in jeopardy because of the constraint on the concessionality of borrowing. It had gone through because the IMF Legal department had ruled that the requirement of a 50-percent grant element applied to the entire project, not the financing component from each

[27] The Debt Sustainability Assessment (DSA) framework, discussed in more detail in the background note on ***The Nature of the Debate Between the IMF and its Critics,*** sets indicative, country-specific debt burden thresholds that depend on the quality of a country's policies and institutions, as measured by the World Bank's Country Policy and Institutional Assessment (CPIA), according to which Rwanda ranks as a "medium performer." The indicative thresholds of potential debt distress for countries in this category are a net present value (NPV) of debt-to-exports ratio of 150 percent, an NPV of debt-to revenue ratio of 250 percent, an NPV of debt-to-GDP ratio of 40 percent, and debt-service-to-exports and revenue ratios of 20 and 30 percent, respectively.

[28] This is because (i) Rwanda's export base is extremely low and the prices of its major exports fell sharply shortly after the Decision point calculations; (ii) the HIPC debt relief calculations are based on a three-year backward –looking average, which did not fully capture this adverse development; (iii) the discount rates used to calculate the NPV of debt fell sharply during the period leading up to Rwanda's Completion Point; and (iv) Rwanda engaged in new concessional borrowing during the period surrounding the Decision and Completion points. Rwanda received significant "topping up" of debt relief at the time of the Completion point, but this did not alter the judgment that its future debt profile, based on the NPV of debt to exports, was precarious according to the DSA framework.

[29] The main fiscal conditionality under the programs—i.e., that which was subject to a formal performance criteria—was a ceiling on the domestic fiscal balance which was defined as revenues (excluding grants) minus current expenditures (excluding external interest) minus domestically-financed capital expenditures and net lending. In other words, externally-financed project spending was never subject to the fiscal ceiling.

[30] Some exceptions were made for one-off "exceptional" expenditure that were meant to be related to the legacy of the genocide and the political transition, however in practice the criteria for inclusion were unclear and the level of scrutiny around inclusion limited. The main significance of the classification was that it removed these expenditure from the primary deficit calculation, with consequences for the DSA.

[31] The approach was first introduced for the 2004 budget, as part of the revised program designed after Rwanda went significantly "off-track" in 2003.

[32] As with priority expenditure, the lack of formalisation of the approach will create problems as the Organic Budget Law is implemented and spending agencies become responsible for budget execution.

[33] The amount of budgeted expenditure designated as contingent was around 1.3% GDP in 2004, 1.7% in 2005, and 1.0% in 2006 and 2007. The categorization of contingent expenditures is not formally recorded in the IMF Board documentation.

[34] However, we understand that the most recently completed program negotiations have agreed on a further increase in the programmed fiscal deficit (before grants) by more than 3 percent of GDP, allowing a further scaling-up of aid-financed public spending.

[35] There is some degree of endogeneity in failure of more concrete plans to emerge in the productive sectors to . Interviews suggested the lack of donor attendance and interest in HIMO is likely to have been read signal by GoR that this program was not going to be supported by donors. Conversely, health and education planning received extensive and ongoing TA as well as high level and high profile engagement by donor and country based advisers.

[36] The Partnership Framework for Budget Support Harmonization and Alignment sets out the division of labor on such issues.

[37] The importance of such program adjustments depends on the predictability of aid flows.

[38] The conditionality took the form of a floor on central government recurrent budget outlays identified as priority spending in line with the PRSP process. The floor was a six-monthly performance criterion (i.e., if the target was not met, the program was automatically interrupted unless the IMF Board granted a waiver.)

[39] Second and Third reviews were completed at the same time.

[40] The conclusions given in bullet 3 are drawn from the Independent Evaluation of Rwanda's PRSP by Evans et al. (2006).
[41] The PRS envisaged a shift away from the categories to the use of public expenditure prioritisation criteria upon which line ministries would base and defend their budget submissions. This however has not been implemented.
[42] For example, the most recent staff report notes that *"Though it would be justifiable to increase the wage bill to hire more teachers or health workers, staff cautioned about using a scaling-up to raise the wages of current public employees."*
[43] For example, during the negotiations over the 2005 budget, the IMF insisted (even in Washington based negotiations with senior Fund officials) on a RWF2bn cut in expenditure, with no clear economic rationale behind it. The Government eventually had to accept this as it could not afford the risk of delaying budget support and HIPC Completion Point.
[44] The limited IMF staff resources devoted to a country like Rwanda was also an important factor.
[45] The independent review of Rwanda's PRSP (Evans et al. 2006) points to the tendency to skew the debate away from more fundamental questions about rights and equity that are at the heart of choices about how "pro-poor" economic policies should be, but does not come to a conclusion as to how much this is driven by internal politics within Rwanda and how much it reflects the technocratic instincts of donors, especially the IFIs, and their natural reluctance to interfere in highly sensitive political choices.
[46] This section is based on World Bank and European Union (2005) "Country Financial Accountability Assessment", and the update provided in Government of Rwanda (2007) "Rwanda Economic Development and Poverty Reduction Strategy Outline Draft". An independent evaluation of Rwanda's PFM system based on the PEFA methodology will be conducted in mid-2007.
[47] A public expenditure tracking survey conducted in 2000 pointed to significant delays in the transfer of public resources from the center to primary beneficiaries and to possible leakages between regional and district health offices (Fofack et al, 2003). The survey found marked differences in the extent to which wage and non-wage expenditures were subject to budgetary shocks. Wage payments, which accounted for the bulk of expenditures by the central government, encountered no significant delays, but non-wage payments suffered substantial within-year delays that were attributed to delays in the release of Treasury resources, reflecting the overall cash flow cycle in which a significant share of resources (taxes and donor budget support) was received late in the year. On average, 80 percent of non-wage transfers to regional health offices in 1999 were received in the last quarter of the year, according to the expenditure tracking survey. Interviews with government officials suggested that improvements in treasury management together with better budget support predictability have considerably reduced these problems.
[48] All MINECOFIN interviewees noted the improvement of budget support predictability since 2005, but raised concerns that these improvements are dependent on sensitive political issues.
[49] Particularly the movement towards a single treasury account through the closure of dormant and unnecessary accounts and the creation of zero balance drawing accounts for spending agencies.
[50] *Mutuelles de sante* are community-based health insurance schemes run at district level.
[51] Including for assisted births, vaccination, visits to health centers.
[52] The EDPRS will place more emphasis on population and family planning issues, and linkages to broader public health issues, such as water and sanitation, nutrition and agriculture, and education.
[53] Available on the MINISANTE website (www.moh.gov.rw).
[54] See EDPRS Self Evaluation Report (2006).
[55] For example, market vendors are barred from markets if they do not have a mutuelle card, passports are not issued without a mutuelle card.
[56] The utilization rate of curative health services (average visits per person) increased from 0.28 in 2002 to 0.473 in 2005. EDPRS Self Evaluation Report (2006).
[57] Health Public Expenditure Review 2005, Interviews with MINECOFIN officials.
[58] Ibid.
[59] Although the recent reduction in staffing in MINISANTE has reduced its effectiveness.
[60] MINISANTE (2006) "L'etat d'avancement des partenaires au developpement dans le processus d'harmonisation et d'alignement dans le secteur de sante au Rwanda"
[61] MINECOFIN & MINISANTE (2006) estimates that only 14% of donor aid to health is spent by central government, and 12% by local government. 55% is spent by NGOs.
[62] Health Public Expenditure Review (2006).
[63] Dr. Ntawukuliryayo, Presentation at High Level Forum 2006.
[64] The MBB tool considers the marginal cost of overcoming gaps in access to minimum packages of health services, easing human resource bottlenecks for implementation of those packages, easing other logistical and technical

bottlenecks related to the quality of the packages, and helping to lift constraints linked to utilization and demand for services.

[65] The IMF has expressed concern about the macroeconomic implications of large unspent balances for projects in the health sector. In particular, the accumulation of large balances in project accounts (especially PEPFAR, Global Fund, Belgian projects) is a "time bomb" waiting to go off if the money is released into the economy. This issue was first raised in mid-2004 and a structural performance criterion on the monitoring of these accounts was introduced from July 2006.

[66] For a further discussion of this see "shadow systems alignment" http://www.odi.org.uk/PPPG/CAPE/publications/kc_shadow_systems_alignment.doc