FISCAL SPACE ANALYSIS METHODOLOGY

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This leaflet is intended to be used alongside a corresponding brief that contains the key FSA findings and recommendations for increasing fiscal space in the Rwandan Social Sectors.

Achieving the National Strategy for Transformation (NST-1) targets and Sustainable Development Goals (SDGs) requires political commitment and a long-term vision, but it also requires that financial resources be invested in social sectors (here defined as the seven sectors: climate change, early childhood development, education, health, nutrition, social protection, and water, sanitation, and hygiene). Resource identification and allocation decisions, however, are complex. It is critical that the macroeconomic limitations on social sector ministries, and the dilemmas faced by Ministries of Finance in allocating resources to social ministries, are understood if both want to effectively leverage domestic public budgets for social sectors.

What is Fiscal Space Analysis?

Fiscal Space Analysis (FSA) uses data and economic projections to model the availability of financial resources within government budgets and compares this with the costs of achieving national targets. It then considers options to close the financing gap between expenditure and costs, providing scenarios that show how different resource allocation and financing options might increase fiscal space to achieve policy targets.

Benefits and uses of FSA to the Ministry of Finance and Social Sector Line Ministries

FSA provides an evidence-based document to underpin and open-up budget negotiations and be used as an advocacy tool for mobilising wider investment from stakeholders. More specifically, it:

- Provides a common analytical base for negotiations between MOF and Line Ministries.
- Highlights serious gaps in financing that will impact the ability of a sector to reach its goals.
- Provides economic and social benefit analysis for investing in social sectors.
- Provides recommendations around different financing options and areas for greater efficiency.
- Acts as an advocacy tool, for example, bringing policy goals and financial constraints to the fore for development partners to consider investing for greater impact.
- Provides recommendations around the needs for improved data, M&E and further in-depth research, i.e., identifying key challenges that need to be overcome.

Aim of the Rwandan Social Sector FSA

The Government of Rwanda and UNICEF requested FSA to:

1. Provide Rwandan policy makers with a sense of how, and over what time, the NST-1 and SDG policy ambitions can be achieved.
2. Simulate a future for available government funds given macroeconomic conditions, expected declining donor funding (as Rwanda becomes a middle-income country), and thus a need for increased domestic sustainability in social sector financing.

Steps in FSA

Our approach embeds FSA within a framework that models the macro-fiscal indicators for the Rwandan economy over time, thus ensuring consideration of possible future scenarios and their effects on the wider economy. The fiscal space analysis involves three steps:

1. **Available Resources** Projected public social sector expenditures are assessed by analysing recent budget execution and current budget allocation.
2. **Estimated Cost** Costs are based on the needs of the population and national goals. Targets are costed using national costed plans if these are available. If not, international norms are used.
3. **Financing Gap** This is estimated by measuring the difference between available resources and estimated costs.

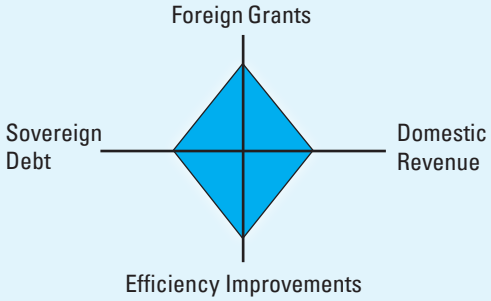
What is Fiscal Space?

The term "fiscal space" is understood in a variety of contexts. It might be interpreted as expressing the overall potential for governments to raise revenue and allocate it across competing priorities. This reflects the economic structure and growth rate of the country, the degree to which government is able to collect taxes, and perhaps more importantly, the social choices that are represented by the way in which the revenue is allocated. These choices are mediated through a complex sequence of political processes that are influenced by a variety of institutional interests competing for limited resources and the structure of the allocations, which may not be easy to change radically in the short run.

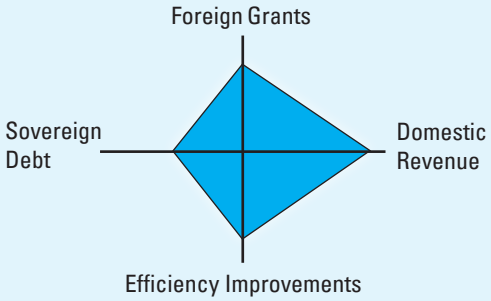
Fiscal space can also be understood in a narrow context as the potential to increase the allocation to a specific sector or set of linked priorities in the short or medium term. Fiscal space can be increased through four pathways.

1. Additional domestic revenue dedicated to a particular purpose
2. Additional foreign grants
3. Efficiency gains
4. Additional borrowing (sovereign debt)

Fiscal Diamond - A country-specific assessment of choices available



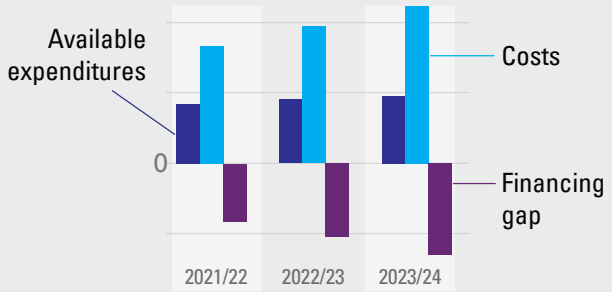
Fiscal Diamond- Increase in domestic revenue



Projecting fiscal space in the short-medium term

Bringing resources and costs together provides a baseline scenario of projections of likely fiscal space for social sector allocations. The projections, showing available government expenditures, costs and the resultant financing gap, span from 2022-2030 and assume no policy changes that may affect levels of social sector expenditure.

Example of baseline scenario projections



A second scenario (best-case) incorporates estimates of the potential for further revenue generation through reprioritisation and revenue mobilisation sources as set out below:

- **Reprioritisation** - Budget reprioritisation towards social sectors (not a source of additional government revenue).
- **Additional taxation** – Domestic taxation reforms expand the tax base and increase revenue.
- **Improving efficiency** – Cross-cutting savings from simultaneous multi-sector investments.
- **External funding** - Donor and other external financing including debt relief.
- **Innovative funding/blended finance** – Public Private Partnerships (PPP), green or climate bonds and Social Impact Bonds (SIB).

These potential financing sources are combined in a step-by-step basis and projections of the financing gap between 2022-2030 are presented.

Example of 'best-case' scenario projections