unicef for every child

Fiscal Space for Children in Rwanda:
A summary of the approach and options

UNICEF Rwanda, July 2018

1. Context

Rwanda continues to ride one of the longest sustained economic growth trajectories in the world with an average annual real GDP growth above 7 per cent over the past two decades. This impressive achievement has been largely driven by public investment, especially in infrastructure, alongside efforts to diversify the economy from one that was mainly agriculture-based to one that increasingly relies on services and industry. This situation has, however, led to an expanding current-account deficit, whereby the value of goods and services that are imported exceeds those that are exported. Rising public debt coupled with declining foreign aid have created the need to tighten fiscal and monetary policies and introduce tough expenditure controls.

In addition to these macro-fiscal challenges, the country is experiencing fast-growing demand for more and improved services that support children. Rwanda – like most African countries – is experiencing a demographic boom that will see its population of children under the age 18 increase from 5.7 million to 6.4 million between 2018 and 2030.[1] As a result, the need to scale up public investment in sectors that benefit children will continue to rise over the foreseeable future. A fiscal space analysis (FSA) investigated the options that are available to the government to address the funding demands of priority sectors for children in Rwanda within a fiscally sustainable framework.

2. Methodology

The FSA used a multiannual fiscal-programming exercise to project the evolution of fiscal space from fiscal year 2017/18 to 2023/24. Historical data and specific macroeconomic assumptions allowed for the estimation of resources that could potentially be created to support children's welfare if directed into priority sectors. These priority sectors are education, health, social protection and water and sanitation.[2] The exercise started by developing a base scenario built on trends of past expenditure, revenue, borrowing, foreign aid, economic output, etc., and using various economic, fiscal and demographic projections from the International Monetary Fund and United Nations. The base scenario was then compared to alternative scenarios in order to identify opportunities for increasing spending on priority sectors that affect children. Unless otherwise stated, the figures presented in this summary used the projection findings from public expenditure and their underlying macroeconomic assumptions.

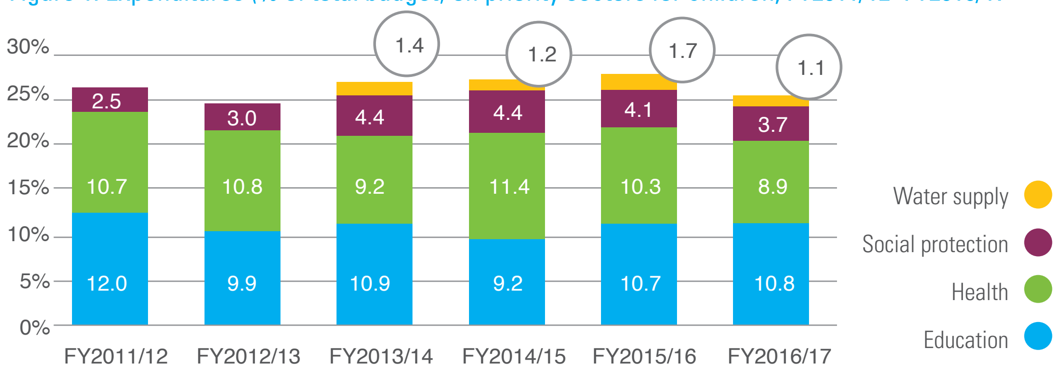
1 According to the National Institute of Statistics' population projections (2012), births will increase from 321,506 in 2012 to 389,087 in 2027 and the school-age population will increase from 4.3 million to 5.6 million between 2012 and 2032, equivalent to an increase of 30 per cent over 20 years.

2 For the purposes of this study, 'priority expenditure' is defined as the recurrent and capital expenditure considered essential for children's welfare. The term 'priority' should not be taken to mean that such expenditure would always be prioritized over other expenditure; it also does not necessarily mean that this is how the Government of Rwanda defines 'priority'. The point is simply to categorize expenditures of priority interest to children in general.

3. Trends in priority-sector spending

Historical expenditure data (revised budgets) show that Rwanda's spending on priority sectors has fluctuated over the past six years (Figure 1). For instance, the education budget as a share of the national budget declined from 12.0 per cent in 2011/12 to 10.8 per cent in 2016/17, while the health budget decreased from 10.7 per cent to 8.9 per cent over the same time period. In contrast, spending on social protection increased from 2.5 per cent to 3.7 per cent of the budget (after peaking at 4.4 per cent in 2013/14 and 2014/15), while spending on water first appeared in fiscal year 2013/14 and has ranged between 1.1 per cent and 1.7 per cent of total spending.

Figure 1: Expenditures (% of total budget) on priority sectors for children, FY2011/12–FY2016/17



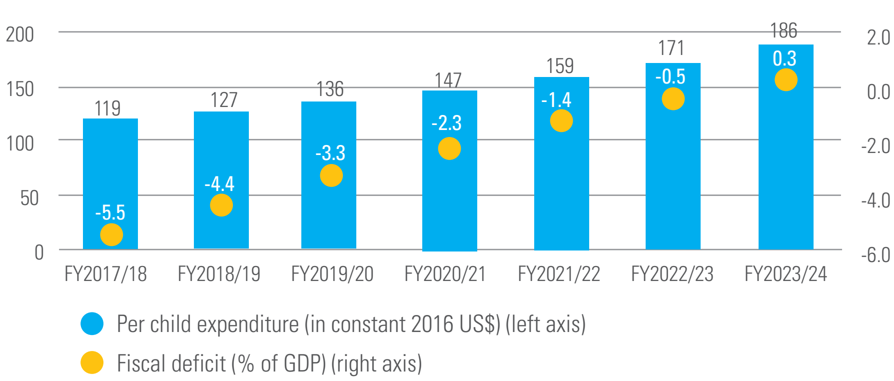
Source: MINECOFIN Revised Budget Finance Laws FY11/12 – FY14/15; MINECOFIN, Budget Execution Reports FY15/16 – FY16/17.
Note: the functional category of water supply was negligible in FY11/12 and not included in the revised budget law for FY12/13.

4. Main findings

4.1. Base scenario

The base scenario assumes that there will be no significant changes in the trends for key macroeconomic indicators: real GDP growth rate will gradually rise to 7.5 per cent by 2023/24; inflation will remain around 4 per cent; and population growth rate will decline slightly from 2.4 per cent in 2017/18 to 2.1 per cent in 2023/24. Taken together, these assumptions imply stability in the evolution of the economy's key ratios. According to the base scenario: (i) annual per-child spending on priority sectors will increase from US$119 to US$186; and (ii) the fiscal balance will go from –5.5 per cent (deficit) to 0.34 per cent (surplus) of GDP.

Figure 2: Base scenario



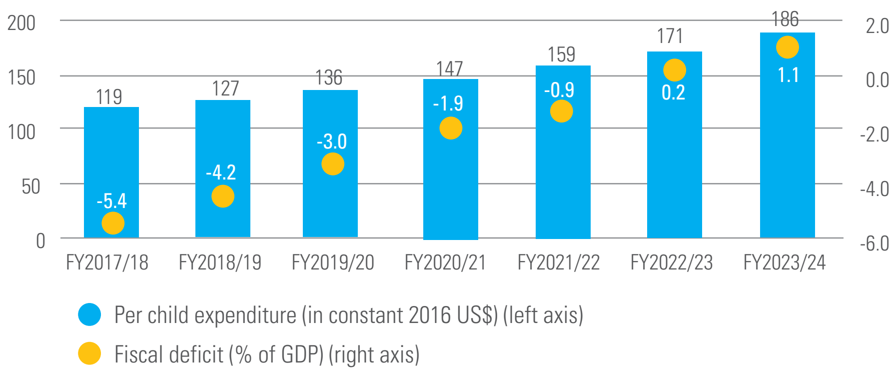
4.2. Alternative scenarios

By improving the efficiency in VAT collection, Rwanda will be able to **increase its expenditure for priority sectors by about 56 per cent by fiscal year 2023/24** while achieving a fiscal surplus and reducing debt.

Scenario 1: Improved VAT collection efficiency

This scenario assumes that, in addition to the assumptions used in the base scenario, domestic VAT collection efficiency will increase from 20 per cent to 25 per cent between 2017/18 and 2023/24, and import VAT collection efficiency will increase from 42 per cent to 54 per cent over the same time period. According to this scenario: (i) annual per-child expenditure will increase from US$119 to US$186; and (ii) the fiscal balance will go from –5.4 per cent to 1.1 per cent of GDP.

Figure 3: Results of increased VAT collection efficiency

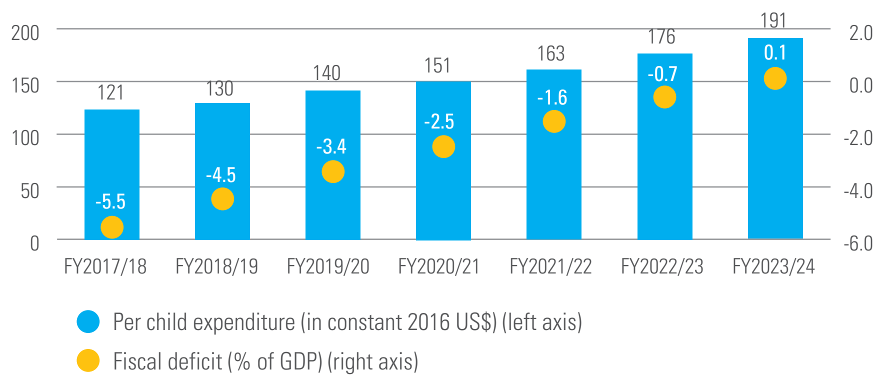


Rwanda could **increase its expenditure for priority sectors by about 58 per cent by 2023/24,** but total debt would be slightly higher than in the base scenario (by 0.95 per cent of GDP).

Scenario 2: Increased priority expenditure through borrowing

This scenario assumes that, in addition to the macroeconomic assumptions used in the base scenario, priority expenditure will increase from 6.0 per cent of GDP in 2017/18 to 6.6 per cent of GDP in 2023/24. According to this scenario: (i) annual per-child expenditure will increase from US$121 to US$191; and (ii) the fiscal balance will go from –5.5 per cent to 0.1 per cent of GDP.

Figure 4: Results of increased priority-sector spending, only



Rwanda will be able to **increase its expenditure for priority sectors by about 58 per cent by 2023/24,** and lower debt levels if it attracts greater foreign aid flows.

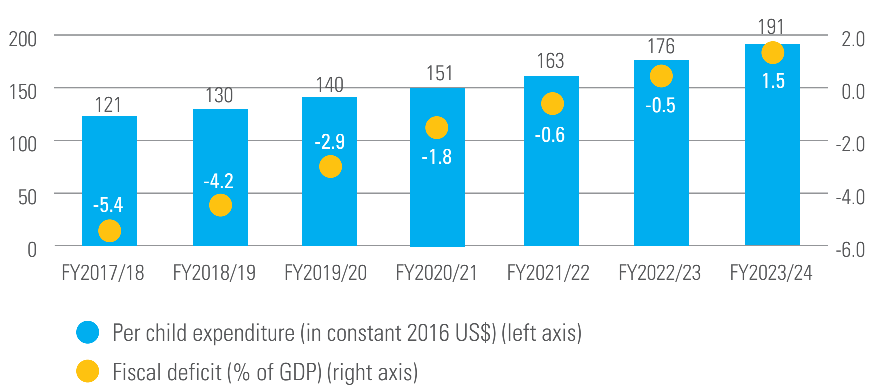
Scenario 3: Combination of Scenarios 1 and 2

This assumes that the increase in priority expenditure would effectively be funded through higher tax revenue as a result of enhanced VAT administration. According to this scenario: (i) annual per-child expenditure will increase from US$121 in 2017/18 to US$191 in 2023/24; and (ii) the fiscal balance will go from –5.4 per cent to 0.9 per cent of GDP.

Scenario 4: Increased external financing to fund priority expenditure

This scenario assumes that, in addition to the macroeconomic assumptions used in the base scenario, priority expenditure will increase from 6.0 per cent of GDP in 2017/18 to 6.6 per cent of GDP in 2023/24 and external grants will increase by 6 per cent by 2023/24. According to this scenario: (i) annual per-child expenditure will increase from US$121 to US$191; and (ii) the fiscal balance will go from –5.4 per cent to 1.5 per cent of GDP.

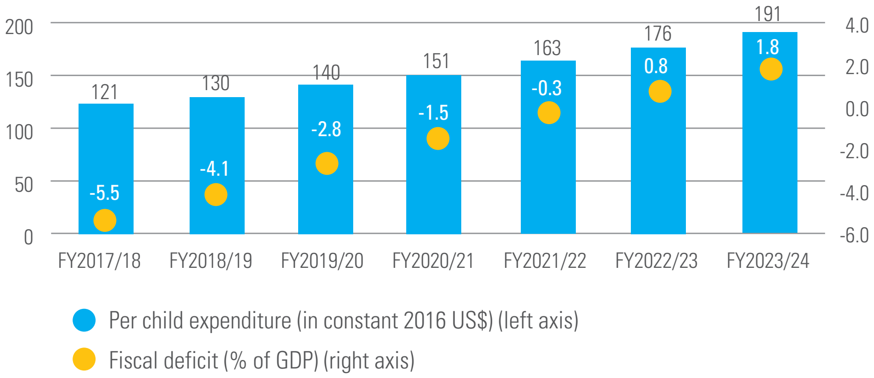
Figure 5: Results of increased external financing



Scenario 5: Reprioritization of expenditures

This scenario assumes that Rwanda will capitalize on its ability to attract more private-sector funding for non-priority expenditures, which will allow the government to increase priority expenditure (by 2 per cent, on average). According to this scenario: (i) annual per-child expenditure will increase from US$121 to US$191; and (ii) the fiscal balance will go from –5.5 per cent to 1.8 per cent of GDP.

Figure 6: Results of reprioritizing expenditure

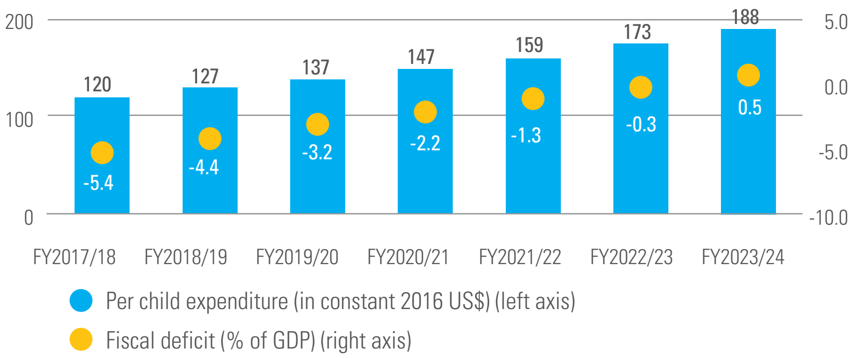


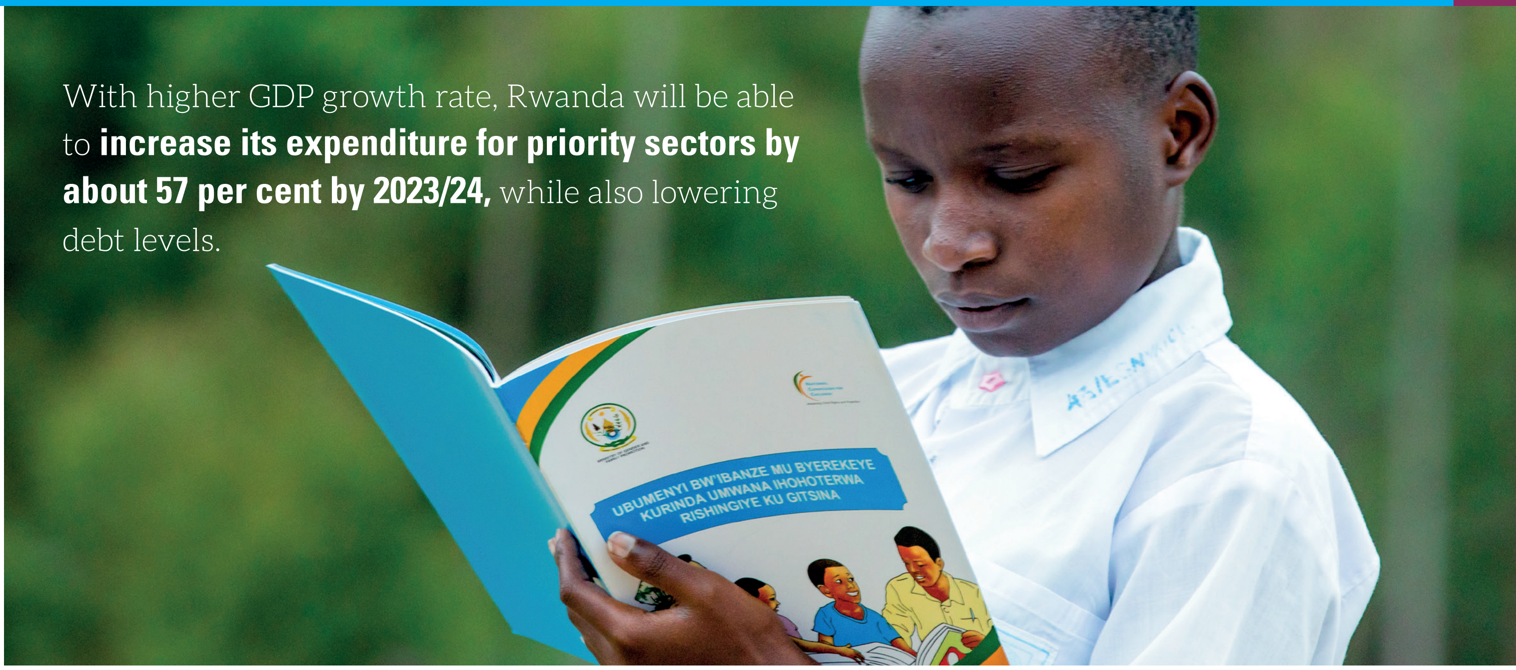
Scenario 6: Higher GDP and revenue growth to fund priority expenditure

This scenario uses the same assumptions as the base scenario, but accounts for faster economic growth in real terms, which gradually increases from 6.3 per cent in 2017/18 to 8 per cent in 2023/24. According to this scenario: (i) annual per-child expenditure increases from US$120 to US$188; and (ii) the fiscal balance goes from –5.4 per cent to 0.5 per cent of GDP.

By reallocating its funds, Rwanda will be able to **increase its expenditure for priority sectors by about 57 per cent by 2023/24,** while also lowering debt levels.

Figure 7: Results of higher GDP growth





5. Other fiscal space options

In addition to the different scenarios already discussed, there are other possibilities that the Government of Rwanda could pursue in order to increase the availability of resources for priority sectors that benefit children. Although the data requirements for these options made them either impossible or overly complex to include in the modelling exercise, they should still be reviewed and discussed:

- Reducing external-debt service through agreements with creditors
- Increasing external-debt disbursements
- Increasing net internal borrowing flows
- Increasing expenditure efficiency at national and local levels
- Increasing local revenues
- Reducing illicit financing flows.

6. Takeaways

Rwanda's options to increase spending on child-focused sectors over the next seven years are constrained. The government must maintain prudent fiscal policy to prevent further declines in its foreign reserves and to control debt stocks. In practice, the current macro-fiscal challenges suggest that the government will find it difficult to find much additional fiscal space over the short term. Nonetheless, there is a strong case to continue dialogue on strategic resource allocation for children. Several key points for consideration are summarized below:

- Although short-term constraints are evident, Rwanda appears more favourably placed to increase its priority expenditure with a medium-term perspective in place;
- The government's National Strategy for Transformation suggests a commitment to prioritize expenditure for children;
- Rwanda could increase per-child priority expenditure without creating a fiscal gap; and
- Rwanda shows strong potential to increase priority expenditure by an additional 2 per cent annually in a fiscally neutral way through increased VAT collection, additional external financing and some minimal reprioritization of the national budget.

Summary of different scenarios per sector

Scenario	Government debt, FY2023/24*	Education**	Health**	Social protection	Water supply**	Total**
0. Base scenario	42.19	66.0	55.2	21.6	6.6	149.4
Policy-based						
1. Enhanced VAT administration (10% increase)	39.7	66.0 (–)	55.2 (–)	21.6 (–)	6.6 (–)	149.4 (–)
2. Increased priority expenditure	43.1	66.9 (+1.3%)	56.6 (+2.5%)	22.6 (+4.8%)	6.8 (+3.4%)	152.9 (+2.4%)
3. Increased priority expenditure and enhanced VAT administration (10% increase)	40.6	66.9 (+1.3%)	56.6 (+2.5%)	22.6 (+4.8%)	6.8 (+3.4%)	152.9 (+2.4%)
4. Increased external grants for social sectors	38.5	66.9 (+1.3%)	56.6 (+2.5%)	22.6 (+4.8%)	6.8 (+3.4%)	152.9 (+2.4%)
5. Reduced non-priority expenditure and increased priority expenditure	37.4	66.9 (+1.3%)	56.6 (+2.5%)	22.6 (+4.8%)	6.8 (+3.4%)	152.9 (+2.4%)
Change in economic growth						
6. Higher real GDP growth	41.1	66.4 (+0.5%)	55.5 (+0.5%)	21.6 (+0.4%)	6.6 (+0.5%)	150.2 (+0.5%)
7. Lower real GDP growth	53.4	62.9 (–4.7%)	52.7 (–4.7%)	20.7 (–3.8%)	6.3 (–4.7%)	142.6 (–4.6%)

Source: Result from fiscal model projections
*As a per cent of GDP on average (FY2017/2018–FY2023/24)
**Average (FY2017/2018–FY2023/24) per-child priority expenditure at 2015 exchange rate and prices; figures in (parentheses) indicate the difference between the alternative and base scenarios