

Fiscal Space for Children: An analysis of options in Rwanda

Summary report





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Executive summary



This analysis of fiscal space reviews the availability of financial resources within the government budget for expenditure directly relevant to children's welfare and development (priority sectors). The analysis also examines and evaluates the available options to increase the overall fiscal space for priority sectors following different scenarios, each having different outcomes and varying implications for the government's capacity to fund its child-relevant priority expenditure. Priority expenditure refers to recurrent and capital expenditure flows considered essential for children's welfare. For the purposes of this study, priority expenditure is defined as spending on a number of sub-sectors in the four sectors of health, education, social protection and water and sanitation.

Spending on priority sectors has been uneven in past years, but this may change in the future as the National Strategy for Transformation I, 2017–2024 (NST) places renewed focus on these sectors. From fiscal year (FY) 2015/16 to FY2016/17, total priority expenditure decreased from 6.4 per cent to 5.9 per cent of gross domestic product (GDP). This declining trend can be explained in the context of the Economic Development and Poverty Reduction Strategy (EDPRS) II, which ran from 2013 to 2018 and prioritized areas related to economic growth. With the new NST, in which the social sectors are prioritized within a separate pillar, this trend may be reversed.

Given the development challenges faced in the priority sectors, there is a clear case for increasing funding for them. Within the priority sectors, important policy challenges still need to be addressed. These are mainly related to improving the quality of service delivery and increasing the impact of policies towards alleviating poverty, which may indicate that, regardless of Rwanda's high budget execution rate, Rwanda could make more optimal use of the funds spent. In addition, each priority sector has faced a fiscal gap, as all sectors were allocated less than they would need based on their plans. An increase in priority expenditure is thus necessary to address these challenges. While in some countries improvements in budget execution and increasing expenditure efficiency are options to deal with inadequate fiscal space, it isn't the

case in Rwanda, which appears to be relatively efficient in expenditure management when compared to its neighbouring countries.

In a baseline scenario that represents an economic status quo with growth averaging around 7 per cent, spending on priority sectors could increase without creating a fiscal gap. Under a set of neutral assumptions, priority expenditure would increase as a percentage of total expenditure and in terms of GDP. Per-child priority expenditure would increase from US\$119.47 in FY2017/18 to US\$185.81 in FY2023/24. The average net internal debt flow would be 0.02 per cent of GDP, which indicates the government could realize this scenario without additional internal borrowing. The fiscal deficit would become a surplus of 0.34 per cent of GDP.

Rwanda could fund a 2 per cent increase in priority expenditure in a number of fiscally neutral ways. The scenarios in this study show that increased efficiency in the collection of value-added tax (VAT), increased grant revenue, and reallocation of expenditure could fund an increase in priority expenditure without increasing the government's fiscal gap and while safeguarding its priority to manage and decrease its total debt. The results of various scenarios are summarised in Table 1.

Alternative scenarios indicate that Rwanda could fund a slight increase of investment in priority sectors through increased efficiency in VAT collection. While the potential to increase tax revenues is limited in the near future, some improvement could be made in VAT collection efficiency. Improved functioning of the e-billing machines could particularly lead to higher efficiency in VAT collection. If VAT collection efficiency increases gradually from 20 per cent in FY2017/18 to 25 per cent in FY2023/24 and import VAT collection efficiency increases gradually from 42 per cent in FY2017/18 to 54 per cent in FY2023/24, average tax and non-tax

Table 1: Summary of projection results of the base and seven alternative scenarios

Results	Scenario							
	Base	1	2	3	4	5	6	7
Ratio of average tax and non-tax revenue as a per cent of GDP, 2017–2024	17.79	18.15	17.79	18.15	17.79	17.79	17.79	17.74
Average priority expenditure (per cent of GDP), 2017–2024	6.16	6.16	6.31	6.31	6.31	6.31	6.15	6.27
Average priority expenditure per child (US\$ at 2015 prices and exchange rate), 2017–2024	149.41	149.41	152.93	152.93	152.93	152.93	150.18	142.60
Net internal debt-to-GDP ratio, 2017–2024	0.02	–0.38	0.18	–0.22	–0.57	–0.56	–0.06	0.86
Total government debt as a per cent of GDP, 2024	42.19	39.71	43.14	40.66	38.53	37.38	41.05	53.36

Base: Status quo

Scenario 1: Improved VAT collection efficiency

Scenario 2: Increased priority expenditure

Scenario 3: Combination of Scenarios 1 and 2 (increase in priority expenditure funded by enhanced VAT administration)

Scenario 4: Increased external financing (grants) to fund priority expenditure

Scenario 5: Reprioritization of expenditure from non-priority to priority by increasing private-sector funding in non-priority sectors

Scenario 6: Higher GDP growth rate

Scenario 7: Lower GDP growth rate

A scenario of higher GDP growth, which could be realized by successfully attracting private-sector funding, would also positively affect priority expenditure.

revenue would increase by 0.37 per cent of GDP in comparison to that of the base scenario over the projection period. This increase in average tax and non-tax revenue to GDP could fund the increase in priority expenditure to US\$190.55 in FY2023/24, compared to US\$185.80 in the base scenario. Under this scenario, it would still be possible to reduce the government debt-to-GDP ratio by 2.48 per cent in 2024 (39.71 per cent) compared to the debt level in 2024 projected by the base scenario (42.19 per cent).

An alternative scenario in which social sectors attract additional external grant funding shows that this would have the potential to increase priority expenditure and limit the level of government debt. While Rwanda aims to reduce its aid dependency, specific grant proposals for social sectors could be successful in generating additional resources for the priority sectors. In a scenario where external grants for current and capital expenditure slowly increase to 3 per cent of GDP in FY2023/24, i.e. a total of 6 per cent of GDP, they could fund an increase in priority expenditure of 0.14 per cent of GDP. Average priority expenditure per child (US\$ at 2015 prices and exchange rate), would increase from US\$149.41 (base scenario) to US\$152.93 and the total debt-to-GDP ratio would decrease from 42.19 per cent (base scenario) to 38.55 per cent in 2024.

Attracting higher levels of private investments could lead to a scenario in which the private sector would fund non-priority expenditure, such as infrastructure, which would enable the government to reallocate funds to priority expenditure. If non-priority recurrent and non-recurrent expenditure funded by the government decreased to 11.9 per cent and 6 per cent of GDP in FY2023/24, respectively, priority expenditure could increase by 0.14 per cent of GDP. This would lead to a decrease in external debt of 4.81 per cent, while the average priority expenditure per child would increase by US\$3.52. It should be noted that this scenario would have different results if private investments do not compensate for the loss of public investments, resulting in a decrease in GDP growth. This would have a negative effect on the increase in priority expenditure.

A scenario of higher GDP growth, which could be realized by successfully attracting private-sector funding, would also positively affect priority expenditure. If the GDP growth rate was higher than assumed in the base scenario, with GDP growing at a rate of 8 per cent in FY2023/24 instead of 7.5 per cent, this would benefit per-child expenditure. An increase in GDP growth rate 0.5 per cent higher than expected would increase per-child priority expenditure to US\$188.04 by FY2023/24 and reduce government debt by 1.14 per cent of GDP compared to the base scenario.

At the same time, if private funding does not take off as expected, a scenario of lower GDP growth could be considered, which would have a negative effect on per-child expenditure. If GDP growth gradually declines from 5.7 per cent in FY2017/18 to 4 per cent in FY2023/24, per-child priority expenditure would still increase over the years, but less than in the base scenario; per-child expenditure would be US\$167.99 in FY2023/24 (compared to US\$185.80 in the base scenario). The debt-to-GDP ratio would increase to 53.36 per cent in FY2023/24. The fiscal deficit would stand at 1.42 per cent of GDP. Also, in this scenario, Rwanda would have a more significant fiscal gap, for which the government would need to resort to internal borrowing.

Increase in priority expenditure is also affected by exogenous factors, notably those affecting the level of economic growth. Should GDP growth be higher than anticipated in the base scenario, priority expenditure could increase by 1 per cent compared to the base scenario. However, should GDP growth slow down to 4 per cent by FY2023/24, priority expenditure would decrease by 5 per cent.

In the near future, improvement of expenditure efficiency and increasing local taxation are less likely scenarios to increase fiscal space. While improving expenditure, increasing efficiency is always advisable. Rwanda, however, already has a relatively high expenditure out-turn at both local and central levels. Local government has great potential to increase revenue, but currently the share of local government taxation as part of total tax collection is too small to have a significant effect on fiscal space. Financing a further increase in priority expenditure through additional external debt is not very likely in the short run, as Rwanda intends to secure its low-debt distress status. Capturing illicit financing flows would increase fiscal space, but this was not captured in this analysis.

In conclusion, notwithstanding the modest scope for increasing fiscal space in the short term, there is a strong case to continue dialogue on strategic resource allocation for children in Rwanda. Rwanda appears to be favourably placed to increase its priority expenditure for children over the medium term. The government's NST suggests a commitment to prioritize such expenditure. The base scenario projects that Rwanda could increase per-child priority expenditure without creating a fiscal gap. Finding additional fiscal space to increase priority expenditure beyond the flow projected in the base scenario is likely to be challenging for Rwanda, but not impossible. Increased VAT collection efficiency, additional external financing, and some reprioritization of expenditure could increase priority expenditure by an additional 2 per cent in a fiscally neutral way.

1.

Introduction



Rwanda's economy has realized constant economic growth, averaging 8 per cent, in the last decade. This has been driven by stable and strong governance, social and economic reforms, and development oriented strategies. Rwanda is, however, still an agriculture-based economy, contributing about 27 per cent to gross domestic product (GDP), and employing more than 70 per cent of the labour force. The service sector's contribution to economy has increased to about 47 per cent of GDP, while the industry sector remains small at about 17 per cent of total GDP (2016 macroeconomic figures).

The fiscal space for Rwanda has been significantly increasing over the last two decades. However, as for other eastern and southern African countries, Rwanda is also experiencing a demographic boom, which implies that the number of children will continue to grow rapidly in coming decades. The need for children's services in health, education, sanitation, nutrition and protection – so-called 'priority sectors' – will significantly increase in the foreseeable future, thus creating fiscal constraints. Rwanda has been experiencing a change in the development financing landscape over the past decade. While official assistance remains an important source of funds for development, its relative importance has begun to slip. To cope with increased demand of public funds to satisfy the needs of priority sectors, the Government of Rwanda will need to continuously identify the best alternatives and allocation options to ensure improved financing in key sectors that directly address the needs of children.

1.1. Objective

This fiscal space analysis (FSA) analyses expenditures considered beneficial to children and defines them as 'priority expenditure'. These include public expenditures under the health, education, water and sanitation, and social protection sectors.

This FSA begins with a review of the recent evolution of the availability of financial resources within the government budget for expenditure directly relevant to children's welfare and development (priority sectors). The analysis then examines and evaluates options to increase the

overall fiscal space available in Rwanda's economy. At the heart of the analysis is exploration of the potential for enhanced future growth of priority expenditure, given the recent and projected revenue and financial constraints as well as the evolution of non-priority expenditure. Thus, the analysis compares the evolution of real expenditure in sectors relevant to children, on the one hand, to the evolution of the rest of the fiscal accounts, on the other, using a series of assumptions with an aim to determine whether any given set of assumptions, taken together, would produce projections in which the priority expenditure programme would be feasibly financed or, if not, how large the financing gap would be.

1.2. Methodology

The FSA has followed Rwanda's official fiscal data and expenditure framework. The data used for the analysis covered the sector budget execution ('functional classification') for fiscal year 2015/16 (FY2015/16) and FY2016/17. The main source of data has been Rwanda's Ministry of Finance and Economic Planning (MINECOFIN). Government finance statistics have been provided directly by MINECOFIN, while revenue breakdown has been estimated using the latest Rwanda Revenue Authority Annual Report (FY2015/16). The macroeconomic aggregates were sourced from the national accounts of the MINECOFIN and the international financial statistics database of the International Monetary Fund (IMF).

For the purposes of this study, 'priority expenditure' has been defined as the recurrent and capital expenditure considered essential for children's welfare. The expression 'priority' should not be taken to mean that such expenditure should always be 'prioritized' over other expenditure. Nor does it mean that this is how the Government of Rwanda defines 'priority'. The point is simply to categorize expenditures of priority interest to children.

1.2.1. Analytical model

The FSA model used in this analysis is a multiannual fiscal-programming exercise, structured to indicate the evolution of the fiscal space under specified macroeconomic programming assumptions: (1) historical economic growth data and (2) programming assumptions. The modelling assumptions followed a constant GDP growth, population growth and consumer price index.

The first phase of this FSA was to compile data and a broad review of the recent evolution of the government budget generally, and priority expenditure in particular.

The second phase of the analysis entailed the formulation of the medium-term projections describing possibilities for the evolution of priority expenditure over a period of seven years from 2017 to 2024, which is the implementation period of Rwanda's new medium-term development strategy, the National Strategy for Transformation, 2017–2024 (NST). Equation 1 shows the computation approach for fiscal space.



The study compared a total of seven alternative scenarios, six of which would enhance fiscal space.

Equation 1: Model of analysis

Total priority, non-interest expenditure

– tax and non-tax, non-interest revenue (excluding external grants)

+ external and internal interest receipts

+ external grants

– total non-priority, non-interest expenditure

+ external debt disbursements

– external debt service (repayment and interest)

– internal interest

+ net internal financing flows

= Fiscal gap

The projection exercise began with the development of a base scenario using a set of key projection assumptions. These were straightforward and non-controversial assumptions to project fiscal space, assuming ‘business as usual’. This base scenario was used for comparison with alternative scenarios developed from different policy approaches.

The study compared a total of seven alternative scenarios, six of which would enhance fiscal space. Determination of these scenarios was based upon literature review and interviews conducted with key stakeholders, such as MINECOFIN, IMF and the World Bank. The selected scenarios, or fiscal space enhancement strategies, have then been expressed quantitatively as programming assumptions for the projection model. The model then described their consequences: first, for the evolution of the priority expenditure and, second, the overall financing requirement. Evolution of the priority expenditure under each scenario has then been evaluated for its adequacy, and the financing requirement for its feasibility.

The projections aimed at understanding how the fiscal space for children can be increased based on basic macroeconomic indicators, such as population growth, GDP growth, and consumer price index, and all alternative fiscal space options were compared with a conservative baseline scenario model, which assumes economic performance at normal pace or policy as usual. The modelling of available fiscal space options has taken into consideration the outcome of public expenditure on per-capita spending in priority sectors and the overall government debt levels. Government debt was selected as a factor because of its long-lasting effect on government spending ability in relevant sectors due to the large share of government spending for debt servicing.

2.

Macro-
economic
outlook

The review of the Rwanda's macroeconomic and fiscal context provides the framework for the FSA and the selection of options and alternative scenarios for sustainable financing of priority sectors for children.

2.1. Macroeconomic indicators and economic structure

Table 2: Key macroeconomic indicators

	Fiscal year					
	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
Gross domestic product*	5,862.5	6,351.1	6,775.5	7,195.1	7,790.1	8,361.9
Real GDP growth rate (%)	7.5	8.3	6.7	6.2	8.3	7.3
Gross domestic product per capita (US\$)**	550.3	581.2	604.7	626.3	661.7	701.6
Real GDP per-capita growth rate (%)	4.8	5.6	4.0	3.6	5.6	6.0
Non-government consumption**	446.9	468.3	481.0	493.5	526.2	552.4
Non-government consumption growth rate (%)	4.4	4.8	2.7	2.6	6.6	5.0
Gross fixed-capital formation (% of GDP)	22.5	23.9	25.2	24.9	25.2	25.7
Central government fiscal surplus (% of GDP)	-3.7	-1.4	-5.2	-4.2	-5.2	-3.6
Merchandise-trade surplus (% of GDP)	-16.1	-18.7	-17.9	-16.8	-16.1	-15.2
Consumer prices (December) growth rate (%)	5.8	5.9	3.7	1.4	2.8	5.5
Exchange rate (December) growth rate (%)	2.4	1.7	4.9	6.2	5.4	8.9
Population growth rate (%)	2.6	2.6	2.5	2.5	2.5	2.3
Under-fifteen population growth rate (%)	2.3	1.8	1.6	1.6	1.4	0.6

Source: IMF International Financial Statistics, World Bank World Development Indicators, MINECOFIN

* Million US\$ at 2015 prices and exchange rate

** US\$ at 2015 prices and exchange rate

Selected macroeconomic indicators (Table 2) indicated that Rwanda has achieved an average annual real GDP growth of 7.4 per cent between FY2010/11 and FY2015/16. This growth surpassed population growth and, as such, the real GDP per-capita growth has been almost 5 per cent per year. The trade deficit rose to 18.7 per cent in FY2011/12, after which it has been declining. Financing of the trade deficit has led to increased borrowing and an increased fiscal deficit.

The Government of Rwanda is undergoing a structural transformation of its economy, to move from a traditional agriculture-based economy to a diversified service-based economy. Over the last two decades of economic growth, public investment accounted for at least half of all investments in Rwanda.

The government invested in infrastructure including electricity, telecommunications and, later, the Internet backbone. More recent investments include increasing off-grid electricity and building a large convention centre aimed at stimulating private-sector development and attracting business tourism (meetings, incentives, conferences and events).¹ As a result, the contribution of the agricultural sector to GDP has decreased from 40 per cent in 2000 to 27 per cent in 2016, although this primary sector still employs about three quarters of Rwanda's economically active population. Contribution of the services and industry sectors to GDP has increased from 50 per cent in 2000 to 65 per cent in 2016. Growth in the industry sector has been driven by construction. In the service sector, growth has been based on trade, transport and real estate activities, notably hospitality and tourism.

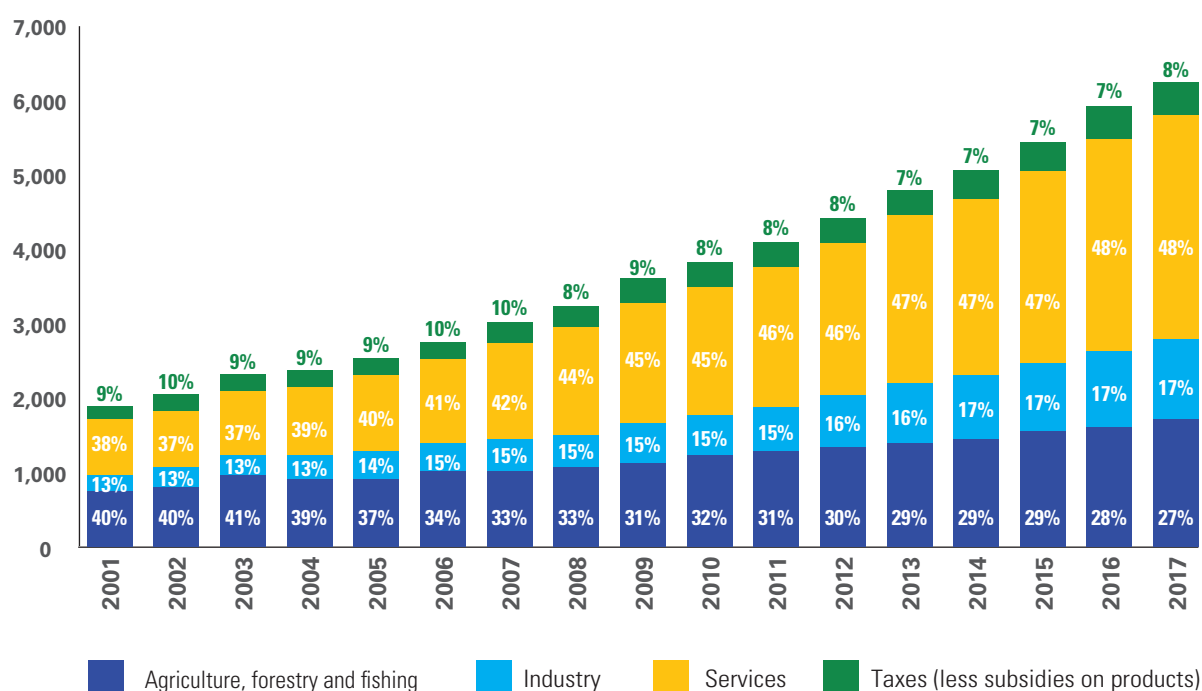


Figure 1: Economic structure: Sectors contributions (%) to GDP (million US\$)

Source: MINECOFIN Macro-Fiscal Framework, July 2017.

Note: Data labels include share of primary, secondary and tertiary sectors.

¹ Kasim Ggombe and Richard Newfarmer, 'Rwanda: From devastation to services-first transformation', WIDER Working Paper 2017/84, United Nations University World Institute for Development Economics Research, April 2017, <https://www.wider.unu.edu/sites/default/files/wp2017-84_0.pdf>, accessed on 12 August 2018.

2.2. Total factor productivity of Rwanda

The Government of Rwanda has put numerous efforts into increasing economic productivity in each of the sectors. Total factor productivity (TFP) expresses the contribution of increased productivity to GDP growth. Figure 2 shows that growth in TFP² has been uneven, and the increase in productivity was lower between 2010 and 2014 than between 2000 and 2010 – meaning in the last five years Rwanda’s technological progress has contributed to a lesser extent to GDP growth than increases in inputs (capital and labour).³

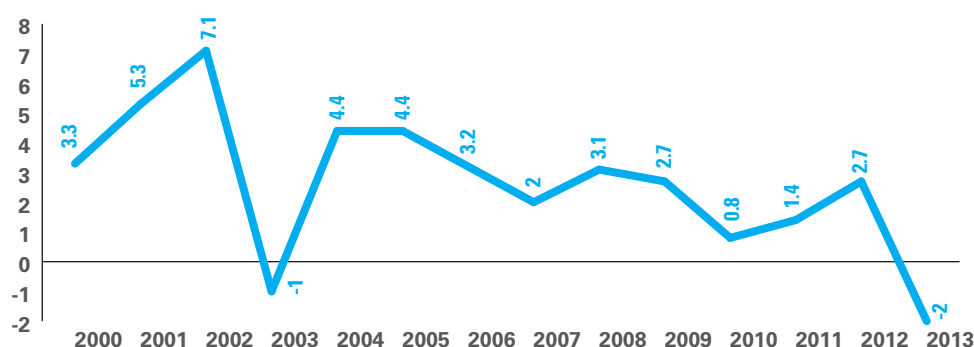


Figure 2: Total factor productivity trend, 2000–2013

Source: University of Groningen and University of California, Davis, Total Factor Productivity at Constant National Prices for Rwanda [RTFPNARWA632NRUG], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/RTFPNARWA632NRUG>, 1 February, 2018.

2.3. Fiscal performance

Rwanda’s fiscal deficit has ranged between 3 and 5 per cent over the past decade (Figure 3). This was partly as a result of government investment projects under the Economic Development and Poverty Reduction Strategy (EDPRS) II, which required increased capital expenditure. Following

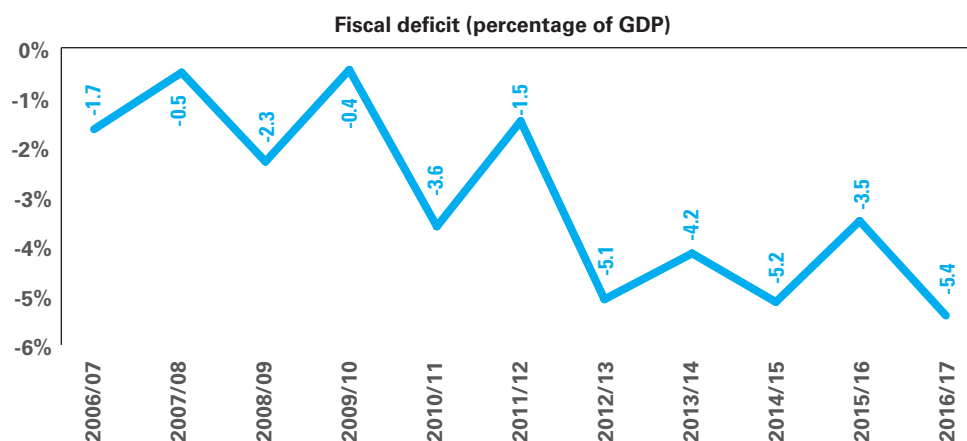


Figure 3: Fiscal deficit, FY2006/07–FY2016/17

Source: MINECOFIN Macro-Fiscal Framework, July 2017

² Total factor productivity (TFP), also called multi-factor productivity, is a variable that accounts for effects in total output growth relative to the growth in traditionally measured inputs of labour and capital. If all inputs are accounted for, then TFP can be taken as a measure of an economy’s long-term technological change or technological dynamism.

³ International Monetary Fund (IMF), ‘Rwanda: Selected Issues’, Country Report No. 17/214, 13 July 2017, <<https://www.imf.org/en/Publications/CR/Issues/2017/07/13/Rwanda-Selected-Issues-45080>>, accessed 13 August 2018.

the increasing current account deficit and the resulting pressures on the external balance, the government's fiscal policy has moved from a more expansionary policy to fiscal consolidation and a prudent borrowing policy.

In MINECOFIN's Budget Framework Paper (April 2017),⁴ the Government of Rwanda stated the following objectives for fiscal policies in the coming years:

- Fiscal and debt sustainability with progress towards the East African Community macroeconomic convergence criteria – the fiscal deficit norm is 3 per cent of GDP;
- A reduction in the external current-account deficit and the concomitant reliance on external financing;
- Further improvement in prioritization and efficiency of public expenditure, in support of growth, poverty reduction, and structural current-account improvement; and
- The overall fiscal deficit (on cash basis), which is projected to reach 4.9 per cent of GDP in FY2018/19 is projected to decline to 4.6 per cent of GDP in FY2019/20 and fall further to 4.4 per cent of GDP in FY2020/21.

2.4. Government revenue

Revenue generation has been a priority for Rwandan economic authorities for decades, with the objective to reach financial self-reliance and mitigate potential external financing shocks and vulnerability. Demanding challenges have been overcome to improve revenue collection. From FY2011/12 to FY2015/16, total revenue has increased from 21.95 to 24.15 per cent of GDP, mainly due to an increase in tax and non-tax revenues, which overcompensated the decrease of on-budget external grants.

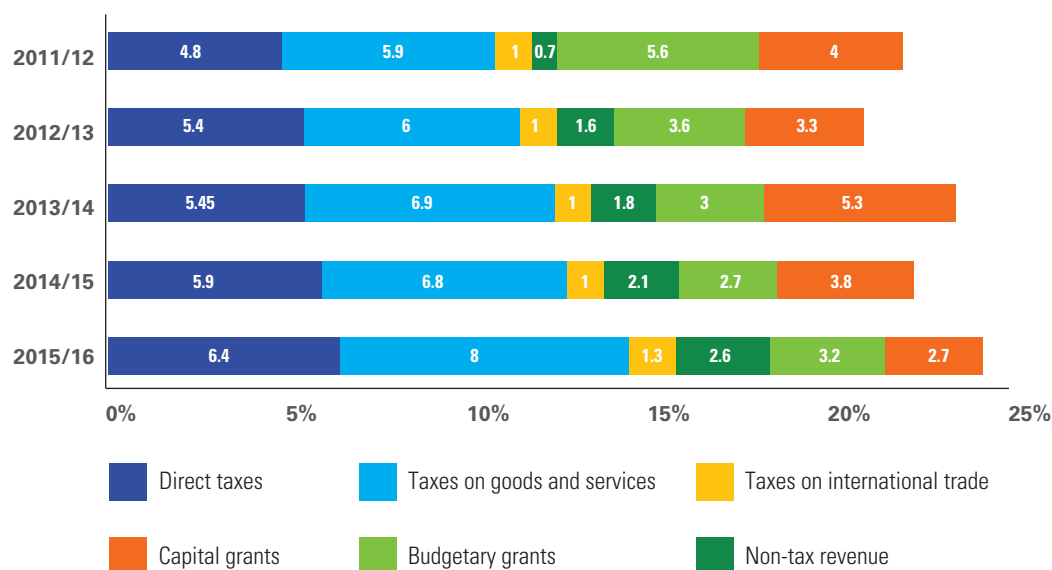


Figure 4: Sources of government revenue as share (%) of GDP, FY2011/12–FY2015/16

Source: MINECOFIN, Macro-fiscal Framework, July 2017

⁴ Ministry of Finance and Economic Planning (MINECOFIN), 'Budget Framework Paper 2017/2018–2019/2020', Kigali, April 2017.

2.5. Public debt

Rwanda's debt-to-GDP ratio has risen significantly since 2014 (Figure 5). The government took on debt to finance large investment projects, such as the expansion of RwandAir and the construction of the Kigali Convention Centre. The declining availability of project grants has meant that the government also has had to contract (concessional) loans for smaller projects.

The government aims, as a matter of policy, to finance its fiscal deficit mainly through concessional external loans. Over the FY2017/18–FY2019/20 period, net domestic financing is planned to be close to zero,⁵ which would reduce the internal debt stock as a percentage of GDP. External public debt would still grow, from 29.8 per cent of GDP to about 38 per cent of GDP in 2020. Since the financing would be concessional, the net present value would be only 26.9 per cent in 2020, below the East African Community (EAC) norm of 50 per cent.⁶ A debt sustainability analysis carried out by the IMF in 2016 shows that, apart from the year 2023 when Rwanda's Eurobond must be refinanced, the baseline sustainability indicators will remain below the danger thresholds (i.e. below the EAC macroeconomic convergences and public debt limits). IMF staff rated the risk of debt distress for Rwanda as 'low', as more than half (58 per cent) of Rwanda's external debt is concessional. Another positive aspect is that Rwanda's debt definition considers contingent liabilities related to large public (–private) sector investments, such as the new airport in Bugesera.

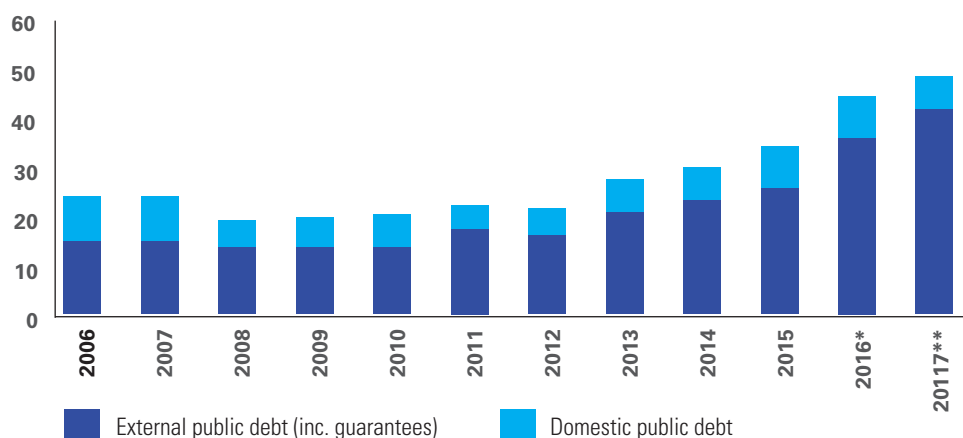


Figure 5: Gross public debt, as percentage of GDP

Source: MINECOFIN, *IMF preliminary figures, **IMF projected figures

⁵ Ministry of Finance and Economic Planning (MINECOFIN), 'Budget Framework Paper 2017/2018–2019/2020', Kigali, April 2017.

⁶ Ibid.



3.

Government
spending
against
selected
benchmarks

This chapter compares Rwanda's spending to international benchmarks, as well as to some other countries with a higher income. While this puts Rwanda's spending levels into context, it does not mean Rwanda's results are below average, nor should Rwanda aim for a certain level of spending. It should be emphasized that global benchmarks for social-sector spending can be considered guidelines, but are not in themselves adequate determinants. For example, a country that spends more on education does not necessarily obtain better results in this sector than a country that spends less on education; efficiency and effectiveness of spending greatly influence its impact.

3.1. Education

United Nations Educational, Scientific and Cultural Organization (UNESCO) has set two benchmarks for spending on education.⁷ Governments should spend between 15 and 20 per cent of their national budgets on education; countries furthest from the targets will need to aim for the higher end of this range. In terms of government spending in education per GDP, UNESCO suggests that low- and lower middle-income countries should spend at least 3.4 per cent of GDP on pre-primary, primary and lower secondary education or 5.4 per cent of GDP across all education levels. The recent spending figures show that the Government of Rwanda has spent around 13 per cent in those areas, equivalent to around 3 per cent of GDP. A comparative analysis with upper middle-income countries shows that the Government of Rwanda's spending on education as a share of total government expenditure is at a similar level to that of Estonia and Finland.

⁷ United Nations Educational, Scientific and Cultural Organization (UNESCO), 'Education for All Global Monitoring Report', Policy Brief, 2015, UNESCO, Paris, <http://unesdoc.unesco.org/images/0023/002326/232654E.pdf>, accessed 13 August 2018.

3.2. Health

In the Abuja Declaration on HIV/AIDS, Tuberculosis and Other Related Infectious Diseases, African Union countries set a target of allocating at least 15 per cent of their annual budget to the health sector; research conducted by Global Health Security Working Group (2014) points at a spending target of 5 per cent of GDP on health. An analysis conducted on the spending of five high-income countries (Korea, Finland, Estonia, Singapore and Israel) on health, as a benchmark in Rwanda's Vision 2050 blueprint, has shown that all spend less than 15 per cent of their total budget on health. However, the difference in spending when compared is quite significant – middle- and high-income countries spend approximately 7 per cent of their budget on health. The Government of Rwanda has spent, as a share of GDP, equivalent to 3.5 per cent in FY2014/15 and 2.4 per cent in FY2015/16 and, as a percentage of total government expenditure, 11.4 per cent in FY2014/15 and 10.3 per cent in FY2015/16.

3.3. Social protection

In 2008 at the African Union conference in Windhoek, African governments committed to a basic social protection floor, the cost of which was determined at 4.5 per cent of GDP. In addition, the International Labour Organization and others have estimated the level of government spending needed to provide basic social protection at between 2.9 and 5.2 per cent of GDP. Rwanda's spending on social protection is below these targets at 1.2 per cent of GDP compared to that of low- and middle-income countries that spend 1.5 and 1.6 per cent of GDP, respectively, on social safety nets; higher-income countries spend 1.9 per cent of GDP on social protection.

3.4. Water supply

Based on two considerations, a target of 0.5 or 1.0 per cent of GDP should be used on water supply. Firstly, a commitment to spend 0.5 per cent of GDP on sanitation and hygiene was made at the 2008 African Union eThekweni meeting by several African ministers responsible for health and/or water.⁸ Secondly, a benchmark of 1 per cent was suggested by the 2006 Human Development Report for low-income countries to spend on water supply and sanitation together.⁹ Rwanda's average expenditure on water supply between FY2013/14 and FY2015/16 was 0.5 per cent of GDP.

⁸ On behalf of Rwanda, the declaration was signed by the Minister of State in Charge of Water and Mines.

⁹ Matthew Martin and Jo Walker, 'Financing the Sustainable Development Goals: Lessons from government spending on the MDGs', Government Spending Watch, 2015 Report, <http://eurodad.org/files/pdf/1546383-financing-the-sustainable-development-goals-lessons-from-government-spending-on-the-mdgs.pdf>, accessed 13 August 2018; United Nations Development Programme (UNDP), 'Human Development Report 2006, Beyond scarcity: Power, poverty and the global water crisis', UNDP, New York, 2006, <<http://hdr.undp.org/sites/default/files/reports/267/hdr06-complete.pdf>>, accessed 13 August 2018.



4.

Fiscal space scenarios and key findings



4.1. Overall summary

Rwanda's macroeconomic context has led to a change in fiscal policy. Over the past 25 years, Rwanda has been one of Africa's most ambitious reformers and one of its fastest growing economies. The government is extremely committed to lifting Rwanda to a higher income status. In recent years, in furtherance of this policy, Rwanda has invested heavily and, partly for this reason, is now facing a situation in which it must carefully control its current-account deficit, at least over the next few years. This means that coming years could be years of slower growth and tighter fiscal constraints.

Rwanda's fiscal policy, because of these developments, has shifted from a rather expansionary to a more prudent approach, aiming at reducing the fiscal deficit and maintaining debt sustainability. Since the government is also facing a reduced inflow of external grants, and is not expecting a large increase in its own tax and non-tax revenue, Rwanda needs to control its expenditure to realize a lower fiscal deficit.

The findings of the FSA presented in this report are the result of exploring various alternative options to increase fiscal space:

- Base (business as is)
- Enhanced value-added tax (VAT) administration (10 per cent increase)
- Increased priority expenditure
- Increased priority expenditure and enhanced VAT administration (10 per cent increase)
- Increased external grants for social sectors and increased priority expenditure
- Reduced non-priority expenditure and increased priority expenditure
- Reduced external debt service (presumably through agreements with creditors)
- Increased external debt disbursements
- Increased net internal borrowing.

Rwanda's options to increase fiscal space within the next seven years are constrained given that it must maintain a prudent fiscal policy because it cannot afford a decrease in foreign reserves and needs to control its external debt. While increasing the tax base is definitely a long-term priority for the government, options to increase revenue collection will not have significant effects over the projection period (FY2017/18–FY2023/24), also considering that revenue income is affected by tax expenditures. In addition, external financing is decreasing in relative terms. Much will depend on the success of Rwanda's policy to attract more foreign investment and private capital.

The projection exercise following the previously mentioned scenarios has produced illustrative results that show alternative means of creating enhanced fiscal space that can be used to finance priority spending.

Some scenarios show that the projected increase in priority spending – a 2 per cent increase in real priority spending per child between FY2017/18 and FY2023/24 (Scenario 2) – could be financed in several different fiscally neutral ways that would not lead to any increase in the level of government debt at the end of the projection period. Such scenarios include:

- A gradual 10 per cent increase in the efficiency of tax administration (increase in VAT collections without any increase in tax rates) (Scenarios 1 and 3).
- An increase of external grants, to 6 per cent of GDP (Scenario 4).
- A re-establishment of priority and non-priority spending, reallocating funding from non-priority sectors to priority sectors (Scenario 5). However, while the reprioritization of expenditure could realize an increase in priority expenditure of 2 per cent, as well as

Table 3: Summary of projection results for all scenarios

	Government debt (% of GDP), FY2023/24	Average priority spending per child, FY2016/17– FY2023/24	% change in priority spending from base scenario
Base scenario	42.19	149.41	=
Policy-making scenarios			
Enhanced VAT administration (10 per cent increase)	39.71	149.41	=
Increased priority expenditure	43.14	152.93	2
Increased priority expenditure and enhanced VAT administration (10 per cent increase)	40.66	152.93	2
Increased external grants for social sectors and increased priority expenditure	38.53	152.93	2
Reduction of non-priority expenditure and increased priority expenditure and increased priority expenditure	37.38	152.93	2
Change in economic growth scenarios			
Higher real GDP growth	41.05	150.18	1
Lower real GDP growth	53.36	142.60	–5

the largest decrease in debt, it should not be forgotten that reprioritization might have consequences on economic growth. A decrease in (capital) expenditure on non-priority sectors, such as infrastructure, could slow down economic growth, which would in turn negatively affect fiscal space and priority spending.

- Scenarios 6 and 7 demonstrate the effects of different potential economic growth. Should economic growth be higher than anticipated, priority spending per child would increase by 1 per cent and, at the same time, decrease debt to 41.05 per cent. If economic growth were lower (and decline to 4 per cent by 2024), this would lead to a decrease of 5 per cent in priority spending per child compared to the base scenario, and debt levels would rise above 50 per cent.

4.2. Base scenario findings

The base scenario regarding Rwanda’s future economic performance reflects the following assumptions (Table 4):

- The real GDP growth rate is assumed to rise gradually, peaking at 7.5 per cent per annum in the final fiscal year (2023/24);
- Consumer-price inflation is assumed to persist at about 4 per cent; and
- The population growth rate is assumed to decline gradually.

Table 4: Basic assumptions regarding growth rates

	Fiscal year						
	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
Real GDP growth rate	6.3	6.5	6.7	6.9	7.1	7.3	7.5
Consumer price index	4.5	4.3	4.2	4.0	4.0	4.0	4.0
Population growth rate	2.4	2.4	2.3	2.3	2.2	2.2	2.1

Taken together, the programming assumptions would imply rough stability in the evolution of the economy’s key ratios. Under these assumptions, priority expenditure would be increasing. As the growth rate would remain high, the fiscal deficit would narrow because revenue would rise faster than expenditure. The net internal financing flow would diminish accordingly, both as a percentage of total expenditure and as a percentage of GDP.

The expenditure flows would imply a negative net internal government debt flow (Table 5). Under the base scenario, the government deficit would decrease from 5.45 per cent of GDP in FY2017/18 to a surplus of 0.34 per cent in FY2023/24, while the net internal fiscal gap would decrease from 2.73 per cent of GDP in FY2017/18 to –3.03 per cent in FY2023/24. The base scenario thus suggests that Rwanda can realize an increase in priority expenditure from US\$119.47 per child to US\$185.81 per child without creating a fiscal gap and, on average, the overall net internal financing gap would be around zero over the projection period.

Table 5: Base scenario projection results

	Fiscal year						
	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
Priority expenditure							
Per cent of total expenditure	20.08	20.79	21.56	22.31	23.11	23.99	24.91
Per cent of GDP	5.89	5.98	6.07	6.16	6.25	6.35	6.45
Per child expenditure in US\$ at 2016 exchange rate and prices	119.47	127.35	136.45	146.85	158.51	171.44	185.81
Net internal financing gap (fiscal gap)							
Per cent of total expenditure	9.30	5.37	1.40	-2.16	-5.58	-8.78	-11.72
Per cent of GDP	2.73	1.55	0.39	-0.60	-1.51	-2.33	-3.03
Fiscal deficit (surplus or deficit)							
Per cent of GDP	-5.45	-4.39	-3.28	-2.31	-1.37	-0.48	0.34



4.3. Alternative scenarios

4.3.1. Alternative Scenario 1: Improved VAT collection efficiency

Rwanda has already implemented numerous reforms to improve revenue administration and tax policy, which means many weaknesses have already been addressed. Compared to other countries, the possibility to increase fiscal space through improving revenue collection is not as strong considering an improvement in the VAT collection efficiency has already been made. Under the assumptions that GDP growth rate, consumer price index and population growth rate stay the same, two assumptions relating to VAT collection efficiency have been altered as compared to the base scenario ('alternative assumptions'). Thus, an assumption is made that domestic VAT collection efficiency increases gradually from 20 per cent in FY2017/18 to 25 per cent in FY2023/24, while import VAT collection efficiency increases gradually from 42 per cent in FY2017/18 to 54 per cent in FY2023/24 (Table 6), increasing efficiency by 10 per cent on average.

Table 6: Key assumptions in Scenario 1

	Fiscal year						
	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
Real GDP growth rate	6.3	6.5	6.7	6.9	7.1	7.3	7.5
Consumer price index	4.5	4.3	4.2	4.0	4.0	4.0	4.0
Population growth rate	2.4	2.4	2.3	2.3	2.2	2.2	2.1
Alternative assumption (compared to base scenario)							
Domestic VAT collection efficiency (%)	20	21	22	23	24	24	25
Import VAT collection efficiency (%)	42	44	46	48	50	52	54

Table 7: Scenario 1 projection results

	Fiscal year						
	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
Priority expenditure							
Per cent of total expenditure	20.08	20.79	21.57	22.33	23.15	24.05	25.00
Per cent of GDP	5.89	5.98	6.07	6.16	6.25	6.35	6.45
Per child in US\$ at 2016 exchange rate and prices	119.47	127.35	136.45	146.85	158.51	171.44	185.81
Net internal financing gap (fiscal gap)							
Per cent of total expenditure	10.20	6.36	2.18	-1.73	-5.72	-9.73	-13.70
Per cent of GDP	2.99	1.83	0.61	-0.48	-1.54	-2.57	-3.53
Fiscal deficit (surplus or deficit)							
Per cent of GDP	-5.36	-4.21	-3.00	-1.92	-0.86	0.15	1.10

Table 8: Comparison of Scenario 1 results to the base scenario

Results	Base scenario	Scenario 1	Variation
Average tax and non-tax revenue as a per cent of GDP, 2017–2024	17.79	18.15	0.36
Average priority expenditure as a per cent of GDP, 2017–2024	6.16	6.16	=
Average priority expenditure per child (US\$ at 2015 prices and exchange rate), 2017–2024	149.41	149.41	=
Net internal debt-to-GDP ratio, 2017–2024	0.02	–0.38	–0.40
Total government debt as a per cent of GDP, 2024	42.19	39.71	–2.48

In terms of per-child expenditure, Scenario 1 projects an increase from US\$119.47 in FY2017/18 to US\$185.81 in FY2023/24 (Table 7), the same as that in the base scenario (Table 8).

When compared to the base scenario (Table 8), with the assumptions of Scenario 1, the average tax and non-tax revenue collection would increase with an average of 0.36 per cent of GDP over the projection period, compared to the base scenario. The share of tax and non-tax revenue to GDP would increase to 18.15 in alternative Scenario 1 against 17.79 in base scenario; net internal borrowing would increase to –0.38 and total government debt to GDP by 2024 would decrease from 42.19 to 39.71.



4.3.2. Alternative Scenario 2: Increased priority expenditure

Alternative Scenario 2, considers an increase (compared to the base scenario) of priority expenditure. It envisages an increase of priority expenditure from 6 per cent of GDP in FY2017/18 to 6.6 per cent of GDP in FY2023/24 (Table 9). Compared to the base scenario, Scenario 2 assumes the priority expenditure (as per cent of GDP) would be on average 2 per cent higher.

When compared to base scenario (Table 10), Scenario 2 demonstrates that using this alternative assumption of a higher-than-expected spending in the priority sectors, priority expenditure would, on average, increase by 0.14 per cent of GDP, compared to the base scenario over the projection period (FY2017/18–FY2023/24). Average per-child priority expenditure would increase by US\$3.52 (from base scenario's US\$149.41 to Scenario 2's US\$152.93 between FY2017/18 and FY2023/24). Overall, compared to the base scenario, increased priority expenditure scenario would increase by 2.4 per cent. Since the increase would need to be funded, the average net internal debt would increase to 0.18 per cent of GDP (compared to 0.02 per cent of GDP in the base scenario), and the share of total government debt to GDP would increase from 42.19 (base scenario) to 43.14 (Scenario 2) over the projection period.

Table 9: Scenario 2 projection results

	Fiscal year						
	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
Priority expenditure							
Per cent of total expenditure	20.27	21.10	21.96	22.75	23.57	24.44	25.34
Per cent of GDP	5.96	6.10	6.22	6.32	6.42	6.52	6.61
Per child in US\$ at 2016 exchange rate and prices	120.86	129.84	139.74	150.71	162.80	176.02	190.55
Per cent change (compared to base scenario)							
Per cent of total expenditure	0.93	1.53	1.85	1.97	1.98	1.89	1.75
Per cent of GDP	1.16	1.95	2.41	2.63	2.71	2.67	2.55
Per child in US\$ at 2016 exchange rate and prices	1.16	1.95	2.41	2.63	2.71	2.67	2.55
Net internal financing gap (fiscal gap)							
Per cent of total expenditure	10.70	7.37	3.70	0.31	−3.12	−6.53	−9.85
Per cent of GDP	3.14	2.13	1.05	0.09	−0.85	−1.74	−2.57
Fiscal deficit (surplus or deficit)							
Per cent of GDP	−5.52	−4.51	−3.44	−2.48	−1.56	−0.68	0.14

Table 10: Comparison of Scenario 2 results to the base scenario

Results	Base scenario	Scenario 2	Variation
Average tax and non-tax revenue as a per cent of GDP, 2017–2024	17.79	17.79	=
Average priority expenditure (per cent of GDP), 2017–2024	6.16	6.31	0.14
Average priority expenditure per child (US\$ at 2015 prices and exchange rate), 2017–2024	149.41	152.93	3.52
Net internal debt-to-GDP ratio, 2017–2024	0.02	0.18	0.16
Total government debt (as a per cent of GDP), 2024	42.19	43.14	0.95

4.3.3. Alternative Scenario 3: Increase in priority expenditure funded by enhanced VAT administration

Scenario 3 combines the assumptions of Scenario 1 and Scenario 2, so that the increase in priority expenditure would effectively be funded through higher tax revenue resulting from enhanced VAT administration. It shows that priority expenditure would grow at the same pace as projected in Scenario 2 (see Table 10), but the net internal financing gap and fiscal deficit will be reduced because of the increased revenue through more efficient VAT collection. Table 11 illustrates the results of Scenario 3.

Table 11: Scenario 3 projection results

	Fiscal year						
	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
Priority expenditure							
Per cent of total expenditure	20.27	21.11	21.97	22.77	23.60	24.50	25.43
Per cent of GDP	5.96	6.10	6.22	6.32	6.42	6.52	6.61
Per child in US\$ at 2016 exchange rate and prices	120.86	129.84	139.74	150.71	162.80	176.02	190.55
Net internal financing gap (fiscal gap)							
Per cent of total expenditure	10.40	6.75	2.72	–1.08	–4.97	–8.90	–12.81
Per cent of GDP	3.06	1.95	0.77	–0.30	–1.35	–2.37	–3.33
Fiscal deficit (surplus or deficit)							
Per cent of GDP	–5.43	–4.33	–3.16	–2.10	–1.06	–0.05	0.90

Table 12: Comparison of Scenario 3 results to the base scenario

Results	Base scenario	Scenario 3	Variation
Average tax and non-tax revenue as a per cent of GDP, 2017–2024	17.79	18.15	0.37
Average priority expenditure (per cent of GDP), 2017–2024	6.16	6.31	0.14
Average priority expenditure per child (US\$ at 2015 prices and exchange rate), 2017–2024	149.41	152.93	3.52
Net internal debt-to-GDP ratio, 2017–2024	0.02	–0.22	–0.24
Total government debt as a per cent of GDP, 2024	42.19	40.66	–1.53

Table 12 compares the projection results of Scenario 3 with those of the base scenario. The average net internal debt flow would be –0.24 per cent of GDP over the projection period (FY2017/18–FY2023/24). This is lower than the 0.18 per cent internal debt projected in Scenario 2 (which assumes only an increase in priority expenditure, without higher revenues) and the 0.02 per cent projected in the base scenario. Total government debt stock (external and internal) would amount to 40.66 per cent of GDP in FY2023/24, 1.53 per cent of GDP lower compared with the debt stock of 42.19 per cent projected in the base scenario. Altogether, the increase in average revenue to GDP could fund the increase in average priority expenditure and would also have positive effects on government debt. The projected increase in VAT efficiency would ‘overcompensate’ the increase of 2 per cent in priority expenditure. The per-child spending will remain the same as that in Scenario 2 (from US\$120.86 in FY2017/18 to US\$190.55 in FY2023/24), which is higher than that of the base scenario.

4.3.4. Alternative Scenario 4: Increased external financing to fund priority expenditure

Although the relative share of external grants has declined, in absolute terms the grant financing is still increasing. As such, there seems to be scope for increased external financing via grants.

The health sector especially is actively pursuing more external financing, by issuing grant proposals. A similar attempt could be made by the other social sectors; for example, the education sector could attempt to raise more funding from grants by more actively approaching donors for support.

Scenario 4 considers an increase of external grants to fund priority expenditure. The increase in priority expenditure is considered to be the same as that in Scenario 2 (i.e. higher than in the base scenario), while external grants for current and capital expenditure will slowly increase to 3 per cent of GDP in FY2023/24, i.e. a total of 6 per cent of GDP. Table 13 lists the standard and alternative assumptions used to project Scenario 4.

Results from the projection of Scenario 4 (Table 14) show that the priority expenditure will grow at the same pace as projected in Scenario 2, but the net internal financing gap and fiscal deficit

Table 13: Key assumptions in Scenario 4

	Fiscal year						
	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
Real GDP growth rate	6.3	6.5	6.7	6.9	7.1	7.3	7.5
Consumer price index	4.5	4.3	4.2	4.0	4.0	4.0	4.0
Population growth rate	2.4	2.4	2.3	2.3	2.2	2.2	2.1
Alternative assumptions							
Total priority non-interest expenditure (% of GDP)	6.0	6.1	6.2	6.3	6.4	6.5	6.6
Central-government external grants for current expenditure (% of GDP)	2.7	2.8	2.8	2.9	2.9	3.0	3.0
Central-government external grants for capital expenditure (projects) (% of GDP)	2.2	2.4	2.5	2.6	2.7	2.9	3.0

Table 14: Scenario 4 projection results

	Fiscal year						
	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
Priority expenditure							
Per cent of total expenditure	20.27	21.11	21.98	22.79	23.64	24.56	25.51
Per cent of GDP	5.96	6.10	6.22	6.32	6.42	6.52	6.61
Per child in US\$ at 2016 exchange rate and prices	120.86	129.84	139.74	150.71	162.80	176.02	190.55
Net internal financing gap (fiscal gap)							
Per cent of total expenditure	10.12	6.15	1.80	−2.34	−6.58	−10.90	−15.21
Per cent of GDP	2.97	1.78	0.51	−0.65	−1.79	−2.89	−3.94
Fiscal deficit (surplus or deficit)							
Per cent of GDP	−5.35	−4.16	−2.90	−1.75	−0.62	0.47	1.51

will be different because of the increased revenue through more grant financing. The per-child expenditure will increase from US\$120.86 in FY2017/18 to US\$190.55 in FY2023/24, while the share of fiscal deficit (or surplus) will increase from −5.35 per cent in FY2017/18 to 1.51 per cent in FY2023/24.

When compared to the base scenario (Table 15), Scenario 5 on increased external financing in priority sector shows that average priority expenditure will increase by 0.14 per cent, the average per child expenditure will increase by US\$3.52, and the total government debt will decrease by −3.66 per cent.

Table 15: Comparison of Scenario 4 results to the base scenario

Results	Base scenario	Scenario 4	Variation
Average tax and non-tax revenue as a per cent of GDP, 2017–2024	17.79	17.79	=
Average priority expenditure (per cent of GDP), 2017–2024	6.16	6.31	0.14
Average priority expenditure per child (US\$ at 2015 prices and exchange rate), 2017–2024	149.41	152.93	3.52
Net internal debt-to-GDP ratio, 2017–2024	0.02	−0.57	−0.59
Total government debt as a per cent of GDP, 2024	42.19	38.53	−3.66

4.3.5. Alternative Scenario 5: Reprioritization of expenditure

Assuming the government will attract more private funding for its non-priority expenditure (e.g. for infrastructure), it could reprioritize some of its own government funding towards the priority sectors. In addition, the government's new NST objectives may entail a renewed focus on social sectors, which would justify such a reprioritization. This scenario investigates what would happen should the government reallocate some of its funding from non-priority to priority expenditure. Scenario 5 considers a decrease of non-priority recurrent and non-recurrent expenditure (decreasing respectively to 11.8 per cent and 5.6 per cent of GDP by FY2023/24), while priority expenditure increases (compared to baseline scenario) as considered in Scenario 2. Table 16 summarizes the alternative assumptions, which construct Scenario 5.

Table 17 shows the results of Scenario 5. Priority expenditure would increase to 27.12 per cent of total expenditure by FY2023/24. This share is higher than in the base scenario, where 25 per cent of total expenditure would be used for priority expenditure by FY2023/24.

Table 16: Key assumptions in Scenario 5

	Fiscal year						
	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
Real GDP growth rate	6.3	6.5	6.7	6.9	7.1	7.3	7.5
Consumer price index	4.5	4.3	4.2	4.0	4.0	4.0	4.0
Population growth rate	2.4	2.4	2.3	2.3	2.2	2.2	2.1
Alternative assumptions							
Central government non-priority, non-recurrent expenditure (% of GDP)	8.0	7.5	7.1	6.7	6.3	5.9	5.6
Central government non-priority, recurrent expenditure (% of GDP)	14.5	14.0	13.5	13.1	12.6	12.2	11.8
Total priority, non-interest expenditure (% of GDP)	6.0	6.1	6.2	6.3	6.4	6.5	6.6

Table 17: Scenario 5 projection results

	Fiscal year						
	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
Priority expenditure							
Per cent of total expenditure	20.30	21.38	22.50	23.56	24.68	25.88	27.12
Per cent of GDP	5.96	6.10	6.22	6.32	6.42	6.52	6.61
Per child in US\$ at 2016 exchange rate and prices	120.86	129.84	139.74	150.71	162.80	176.02	190.55
Net internal financing gap (fiscal gap)							
Per cent of total expenditure	10.54	6.40	1.83	-2.53	-7.02	-11.58	-16.13
Per cent of GDP	3.09	1.82	0.51	-0.68	-1.83	-2.92	-3.93
Fiscal deficit (surplus or deficit)							
Per cent of GDP	-5.47	-4.14	-2.76	-1.52	-0.33	0.79	1.84

Under the alternative Scenario 5, the average net internal debt flow between FY2017/18 and FY2023/24 would be –0.56 per cent of GDP compared to 0.02 per cent of GDP in the base scenario (Table 18). The total (external and internal) government debt stock would amount to 37.38 per cent of GDP in FY2023/24 under Scenario 5 (compared with 42.19 per cent in the base scenario). A reprioritization would thus not only lead to increased priority expenditure, but could also decrease the debt-to-GDP ratio and result in a positive internal borrowing flow. This result can be explained by the assumption that non-priority non-recurrent expenditure will decrease. Non-recurrent expenditure usually requires more borrowing. Hence, because non-recurrent expenditure decreases, it is expected that less borrowing would be necessary. Per-child expenditure would increase by US\$3.52 following Scenario 5 instead of the base scenario.

Table 18: Comparison of Scenario 5 results to the base scenario

Results	Base scenario	Scenario 5	Variation
Average tax and non-tax revenue as a per cent of GDP, 2017–2024	17.79	17.79	=
Average priority expenditure (per cent of GDP), 2017–2024	6.16	6.31	0.14
Average priority expenditure per child (US\$ at 2015 prices and exchange rate), 2017–2024	149.41	152.93	3.52
Net internal debt-to-GDP ratio, 2017–2024	0.02	–0.56	–0.58
Total government debt as a per cent of GDP, 2024	42.19	37.38	–4.81



4.3.6. Alternative Scenario 6: Higher GDP growth

Rwanda is focused on sustaining high GDP growth. If its policies of import substitution and export promotion, and other measures to attract private funding, take off, a higher GDP growth rate than assumed in the base scenario would be possible. Scenario 6 uses the same assumptions as the base scenario with one difference: that the real growth rate is higher than the growth assumed in the base scenario, gradually increasing from 6.3 per cent in FY2017/18 to 8 per cent in FY2023/24. As a result, the share of priority expenditure would reduce somewhat when expressed as a percentage of GDP, because the GDP would increase. However, per-child expenditure would be positively affected and increase exponentially over the projection period from US\$119.5 in FY2017/18 to US\$188.04 in FY2023/24 (Table 19).

When the results of Scenario 6 on high growth are compared to those of the base scenario (Table 20), the average expenditure per child increases by US\$0.77 and total government debt over GDP slightly reduces from 42.29 per cent to 41.05 per cent.

Table 19: Scenario 6 projection results

	Fiscal year						
	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
Priority expenditure							
Per cent of total expenditure	20.08	20.79	21.57	22.33	23.14	24.04	24.99
Per cent of GDP	5.89	5.98	6.07	6.15	6.24	6.33	6.42
Per child in US\$ at 2016 exchange rate and prices	119.50	127.46	136.69	147.33	159.37	172.86	188.04
Per cent change (compared to base scenario)							
Per cent of total expenditure	0.00	0.02	0.04	0.08	0.13	0.21	0.32
Per cent of GDP	-0.01	-0.04	-0.09	-0.15	-0.22	-0.30	-0.39
Per child in US\$ at 2016 exchange rate and prices	0.02	0.08	0.18	0.33	0.54	0.83	1.20
Net internal financing gap (fiscal gap)							
Per cent of total expenditure	10.47	6.92	3.03	-0.58	-4.25	-7.92	-11.53
Per cent of GDP	3.07	1.99	0.85	-0.16	-1.15	-2.09	-2.96
Fiscal deficit (surplus or deficit)							
Per cent of GDP	-5.44	-4.37	-3.24	-2.24	-1.26	-0.34	0.53

Table 20: Comparison of Scenario 6 results to the base scenario

Results	Base scenario	Scenario 6	Variation
Average tax and non-tax revenue as a per cent of GDP, 2017–2024	17.79	17.79	=
Average priority expenditure (per cent of GDP), 2017–2024	6.16	6.15	-0.01
Average priority expenditure per child (US\$ at 2015 prices and exchange rate), 2017–2024	149.41	150.18	0.77
Net internal debt-to-GDP ratio, 2017–2024	0.02	-0.06	-0.08
Total government debt as a per cent of GDP, 2024	42.19	41.05	-1.14

4.3.7. Alternative Scenario 7: Lower GDP growth

Rwanda could also face external shocks, such as commodity price volatility or rising regional tensions, which would negatively affect its economic growth. This scenario therefore considers a GDP growth lower than that of the base scenario. While other assumptions of the base scenario remain the same, the GDP growth rate would fall to 4 per cent in FY2023/24. Lower GDP growth rate would reduce the percentage of total expenditure spent on priority sectors in FY2023/24 from 24.97 per cent in the base scenario to 24.19 per cent in Scenario 7 (Table 21). Per-child expenditure would decrease to US\$167.99 in FY2023/24 compared to US\$185.81 in the base scenario (Table 21) and, over the period (FY2017/18–FY2023/24), an average per-child expenditure US\$6.82 lower than that in the base scenario (Table 22).

Table 21: Scenario 7 projection results

	Fiscal year						
	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
Priority expenditure							
Per cent of total expenditure	20.07	20.75	21.47	22.13	22.80	23.51	24.19
Per cent of GDP	5.90	6.01	6.13	6.26	6.39	6.54	6.68
Per child in US\$ at 2016 exchange rate and prices	119.08	126.09	133.69	141.85	150.37	159.09	167.99
Per cent change (compared to base scenario)							
Per cent of total expenditure	−0.05	−0.19	−0.44	−0.81	−1.34	−2.02	−2.87
Per cent of GDP	0.20	0.55	1.03	1.60	2.25	2.94	3.67
Per child in US\$ at 2016 exchange rate and prices	−0.33	−1.00	−2.02	−3.40	−5.13	−7.20	−9.59
Net internal financing gap (fiscal gap)							
Per cent of total expenditure	10.76	7.79	4.79	2.35	0.14	−1.82	−3.49
Per cent of GDP	3.16	2.26	1.37	0.67	0.04	−0.51	−0.96
Fiscal deficit (surplus or deficit)							
Per cent of GDP	−5.53	−4.64	−3.75	−3.05	−2.42	−1.88	−1.42

4.3.8. Overview of the effects of specific scenarios on priority sectors

Table 22: Comparison of Scenario 7 results to the base scenario

Results	Base scenario	Scenario 7	Variation
Average tax and non-tax revenue as a per cent of GDP, 2017–2024	17.79	17.74	−0.04
Average priority expenditure (per cent of GDP), 2017–2024	6.16	6.27	0.11
Average priority expenditure per child (US\$ at 2015 prices and exchange rate), 2017–2024	149.41	142.60	−6.82
Net internal debt-to-GDP ratio, 2017–2024	0.02	0.86	0.84
Total government debt as a per cent of GDP, 2024	42.19	53.36	11.17

The effect of each of the seven scenarios on each of the four priority sectors is detailed in Table 23. The increase in priority expenditure is modelled on an increase of 1.3 per cent per-child education priority expenditure; 2.5 per cent per-child health priority expenditure; 4.8 per cent per-child social protection priority expenditure; and 3.4 per cent per-child water supply priority expenditure. These increases could be financed by means of Scenario 3 (a combination of increased expenditure through gains from enhanced VAT administration), Scenario 4 (increased external grants for social sectors) or Scenario 5 (reduction of non-priority expenditure) – and at the same time decrease government debt. Economic growth would also affect the level of per-child expenditure. A higher-than-projected economic growth would increase per-child priority expenditure in each sector by about 0.5 per cent. Should GDP growth be lower than anticipated, this could result in 4.7 per cent decrease in per-child priority expenditure in most sectors, and 3.8 per cent decrease in per-child social protection priority expenditure.

Table 23: Summary of scenario results per sector

	Government debt, FY2023/24*	Sector**				
Scenario		Education	Health	Social protection	Water supply	Total
0. Base	42.19	66.01	55.24	21.56	6.61	149.41
Policy-based						
1. Enhanced VAT administration (10% increase)	39.71	66.01 (–)	55.24 (–)	21.56 (–)	6.61 (–)	149.41 (–)
2. Increased priority expenditure	43.14	66.88 (+1.3%)	56.62 (+2.5%)	22.59 (+4.8%)	6.83 (+3.4%)	152.93 (+2.4%)
3. Increased priority expenditure and enhanced VAT administration (10% increase)	40.66	66.88 (+1.3%)	56.62 (+2.5%)	22.59 (+4.8%)	6.83 (+3.4%)	152.93 (+2.4%)
4. Increased external grants for social sectors	38.53	66.88 (+1.3%)	56.62 (+2.5%)	22.59 (+4.8%)	6.83 (+3.4%)	152.93 (+2.4%)
5. Reduced non-priority expenditure and increased priority expenditure	37.38	66.88 (+1.3%)	56.62 (+2.5%)	22.59 (+4.8%)	6.83 (+3.4%)	152.93 (+2.4%)
Change in economic growth						
6. Higher real GDP growth	41.05	66.36 (+0.5%)	55.53 (+0.5%)	21.65 (+0.4%)	6.64 (+0.5%)	150.18 (+0.5%)
7. Lower real GDP growth	53.36	62.9 (–4.7%)	52.66 (–4.7%)	20.73 (–3.8%)	6.3 (–4.7%)	142.6 (–4.6%)

* 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 (difference in % compared to the base scenario)

4.3.9. Other possible options to increase fiscal space

The Government of Rwanda has other options to increase fiscal space for children, which have not been used in these projections:

- Reducing external-debt service through agreements with creditors
- Increasing external-debt disbursements
- Increasing net internal borrowing flows
- Increasing expenditure efficiency
- Increasing local revenues or increased efficiency in local expenditures
- Reducing illicit financing flows.



5.

Conclusion



Rwanda's current fiscal policy recognizes that the scope for increased domestic and external revenue is limited, and prescribes careful borrowing and expenditure control. Given the need to control the current-account deficit, the government's fiscal policy has moved from a more expansionary policy to fiscal consolidation and a more prudent borrowing approach. On the revenue side, the next two to three years offer little scope for additional inflows from own tax and non-tax revenue and external grants. Thus, Rwanda aims to control its current and capital expenditure to limit the fiscal deficit and avoid having to engage in large-scale borrowing, which would endanger its present low likelihood of debt distress.

The macroeconomic and fiscal situation thus suggests that Rwanda will find it difficult to find much additional fiscal space, at least in the next two to three years. This is plainly relevant for those advocating increased spending on child-friendly sectors, especially since, as at the same time Rwanda must dedicate the resources necessary to enhance economic growth – which is, after all, the key to enhancing the fiscal space in the medium and longer term.

Spending on priority sectors has been uneven over the past years, but this may change in the future if the NST places a renewed focus on these sectors. For the purposes of this study, 'priority' sectors have been defined as a set of sub-sectors of education, health, social protection and water supply and sanitation. Spending in these budget categories is called priority expenditure or priority spending. Analysis has shown that spending on education, health, social protection and water and sanitation in Rwanda is below international benchmarks. This is not completely surprising, as the EDPRS II was focused on economic growth and to a lesser extent on education and health. However, the upcoming NST includes a separate pillar for the social sectors, and it is likely that this will help ensure that future priority spending will be set on a stable growth trajectory.

While in all priority sectors much progress has been made, challenges persist. Given these development challenges, there is a clear case to increase priority spending. In the past few years, the priority sectors' funding fell short of what they needed to fully execute their plans. While

in some countries improvements in budget execution and increasing expenditure efficiency are options to deal with inadequate fiscal space, this is not so for Rwanda, which appears to have highly efficient expenditure management.

The fiscal space analysis has identified options that are likely to increase the fiscal space for priority areas as well as contribute to decreasing the level of external public debt:

- Increased VAT collection efficiency could improve revenue generation as the potential to increase other tax revenues in the near future is limited. The additional revenue generated from this improvement could fund an increase in priority expenditure higher than that in the base scenario and have a positive effect on government debt.
- Additional external grant funding for social sectors has the potential to increase priority expenditure. An increase of external grants to 6 per cent of GDP, for example, would enable the government to increase priority expenditure while reducing government's debt stock as a percentage of GDP.
- Reallocation of funding from non-priority sectors to priority sectors would increase priority expenditure and could decrease debt. However, it is uncertain if such a scenario would be advisable. Reprioritization would not only lead to increased priority expenditure, but could also decrease the debt-to-GDP ratio and result in a positive internal borrowing flow. This result can be explained by the assumption that non-priority non-recurrent expenditure will decrease. Non-recurrent expenditure usually requires more borrowing. Hence, because non-recurrent expenditure decreases, it is expected less borrowing needs to take place. However, this scenario could also turn out very differently. It is important to remember, that non-priority expenditure includes infrastructure investment. If infrastructure investment is lower, real GDP growth is likely to be lower. Since the growth of tax revenue depends on real GDP growth, such reallocation could end up reducing fiscal space over the medium term.
- Additional external debt to finance an increase in priority expenditure is a less feasible option in the short run. Generally, caution is needed when funding social investments



with commercial debt because the maturity of the debt is usually not in line with the long-term yields likely to result from investment in health, education and social protection. Concessional debt would be more suitable for this purpose, but the availability of concessional debt is diminishing and Rwanda may want to be careful accumulating more debt, which could endanger its low level of debt distress.

In the short term, scenarios that involve increasing expenditure efficiency and local taxation would not have a significant effect on fiscal space in Rwanda. Increasing expenditure efficiency (i.e., improving budget execution), while always desirable, is less important as a means of augmenting fiscal space because Rwanda already manages a relatively high budget execution at both local and central levels. Local governments have great potential to increase their revenues but, at the moment, the share of local government taxation as part of total tax collection is too small to have a significant effect on fiscal space. However, capturing illicit financing flows would increase fiscal space, but this could not be captured in the projection results.

In summary, Rwanda appears to be favourably placed to increase its priority expenditure over the medium term. The government's upcoming NST suggests a commitment to prioritize such expenditure. The present base scenario projects Rwanda could increase its per-child expenditure adequately without creating a significant fiscal gap. Alternative Scenarios 1–5 suggest an increase of per-child spending in priority sectors from US\$120.86 in FY2017/19 to a maximum of US\$190.55 in FY2023/24, while at the same time decreasing government debt levels in most scenarios. Alternative Scenarios 6 and 7 suggest, however, that GDP growth can be expected to affect priority expenditure through its effect on the fiscal space. An increase in GDP growth (Scenario 6) suggests increased per-child priority expenditure by US\$0.77 with the government debt level decreased by 1.14 per cent compared to the base scenario (business as usual), while lower GDP growth (Scenario 7) suggests a decrease in per-child priority expenditure by US\$6.82 and an increase in debt level by 11.17 per cent of GDP.

