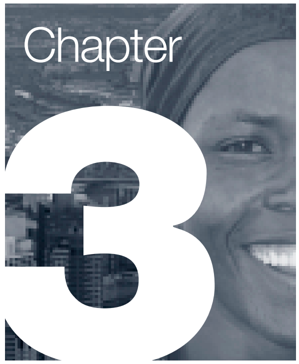


Rwanda—HIPC Contradictions Restrain Development

Amid war, genocide, and conflict in neighbouring Burundi and the Democratic Republic of Congo, the Rwandan economy grew by 9.9% in 2002. This impressive performance was driven partly by favourable weather that boosted agricultural output. Inflation stayed under 4% in 2001 and 2002. But the large spending requirements of social reconstruction raise problems for macroeconomic policy, particularly fiscal management.

"The large spending requirements of social reconstruction raise problems for macroeconomic policy"

In the years after the civil war, security had to be reestablished in the face of threats by armed groups. A grave humanitarian emergency followed the killing of 800,000–1,000,000 people in a population of 7.5 million in the spring of 1994. The violence also displaced some 2 million civilians and destroyed infrastructure and assets. Rural areas suffered particularly from the loss of labour and livestock. The proportion of people in poverty rose from 48% in 1985 to 68% in 2000. In addition, female-headed and child-headed households had little access to land or labour markets.

Despite these challenges the fiscal deficit fell from 13.2% of GDP in 1996 to 8.3% in 1998. But it bounced back to 11% of GDP in 2002 and will remain high over the medium term. The Poverty Reduction Growth Facility, agreed in late 2002 with the International Monetary Fund (IMF), made some allowance for "exceptional" expenditures for people's courts (*gacaca*), demobilization, the genocide survivors fund, and three governance commissions. But some development partners recommend that Rwanda, with large fiscal deficits financed by grants and international borrowing, should reduce the deficit in the medium term rather than mobilize additional resources.

Further contradictions have emerged with Rwanda's heavily indebted poor country (HIPC) status. The use of exports in the HIPC debt sustainability ratios means that the level of debt to exports will be high for countries with low exports, such as Rwanda. This has increased the debt relief, but it also means reductions in new borrowings to maintain the sustainability of debt. So, over the medium term, rising spending needs for poverty reduction and post-genocide reconstruction make it unlikely that Rwanda can adhere to low debt to GDP ratios as required by the HIPC Initiative—because that would reduce the government's ability to contract new loans. Clearly, adherence to HIPC debt ratios has hidden costs that may easily outweigh the benefits.

A longer term development policy and reform agenda is articulated in the government's *Vision 2020,* with the objective of becoming a middle income country. Poverty reduction objectives have been crystalized in the Poverty Reduction Strategy and institutionalized through more transparent budgetary procedures (box 3.1).

Box 3.1
Rwanda's Vision 2020

Eight years on from the 1994 genocide, Rwanda is entering a new phase of reconstruction, set out in the *Vision 2020*. The key parts of *Vision 2020*:

Good governance. Grassroots democratization is essential for increasing popular participation. Given recent history, security is also a priority, along with the promotion of human rights. Sound economic management and macroeconomic stability are also an integral part of good governance.

Rural economic transformation. Recapitalization and transformation of the rural economy are essential to increase agricultural incomes and off-farm employment.

Development of services and manufacturing. Development of industrial and service sectors and the reestablishment of Rwanda as a regional trade center are other important sources of growth.

Human resource development. Rwanda has a scarcity of human capital. Increases in educational attainment are required to close the skills gap. Better health care services are also a priority, to reverse the decline in health indicators and deal with malaria and HIV/AIDS.

Development of the private sector. The business environment needs to be reformed to reduce the risks of doing business in Rwanda. Liberalization, privatization, and increased public-private partnership are also needed, as well as formalization of the informal sector.

Regional and international economic integration. Rwanda, a member of the Common Market for Eastern and Southern Africa (COMESA), is committed to exploiting the opportunities offered by similar frameworks, including the U.S. Africa Growth and Opportunity Act (AGOA).

Poverty reduction. This is the ultimate aim of all other objectives. Reduction of inequality is also essential, including that arising from gender and age.

Selected targets for *Vision 2020*

Indicator	2000	2020 target
Literacy (%)	48	100
Life expectancy (years)	49	55
Infant mortality rate (per 1,000 live births)	110	30
Poverty (% under $1 a day)	64	30
Erosion-protected land (%)	20	100
Secondary teachers, qualified (%)	20	100

Source: *Rwanda Ministry of Finance 2002b, 2002c.*

Recent economic developments

Growth over the last 10 years was strongly affected by the genocide of 1994 (box 3.2), when GDP collapsed by around 50%, and then by the postwar reconstruction, when it boomed to 18% on average between 1995 and 1998. After that, growth stabilized, falling to 6% in 2000 and 6.5% in 2001. Despite strong growth in recent years, per capita GDP has not returned to prewar levels (figure 3.1). Sustained per capita income growth, rising living standards, and poverty reduction have remained limited by structural and environmental constraints. Productivity growth in agriculture, by far the largest sector

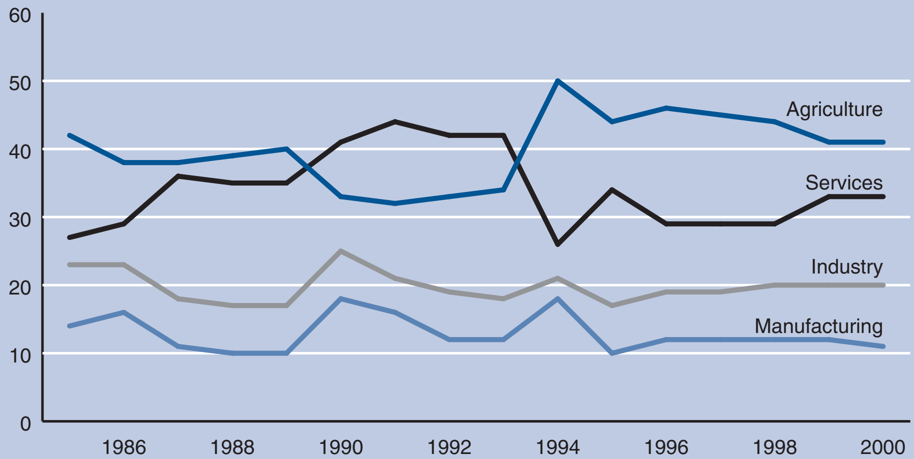
Box 3.2

How conflict affects development

Social disintegration during war pushes up transaction costs as informational access deteriorates and contract enforcement becomes a problem. Machinery and tools are especially vulnerable to looting and destruction. The economy therefore shifts from transaction-intensive and asset-vulnerable sectors towards those less transaction-intensive and asset-vulnerable.

The structural change in the figure seems to suggest these factors at work in Rwanda. The agricultural sector is likely to be the least transaction-intensive sector. The share of agriculture in GDP rose sharply over 1994, interrupting a previous decline. There was also a sharp decline in the share of the service sector, with many transaction-dependent firms, such as banks and trading companies. The economy has not yet reverted to its pre-conflict structure, but the slight decline in the share of agriculture in GDP and the increase in the service sector's share may indicate a gradual return to the market. It is essential to revive the credibility of the exchange mechanism and to provide supporting infrastructure, such as roads. Rebuilding trust through policies fostering social reconciliation is also essential.

Trends in sectoral shares, 1985–2000 (% of GDP)



Source: *Economic Commission for Africa, from official sources.*

of the economy, has remained sluggish. With high population growth rates, this has put a brake on sustained improvements in living standards.

The real sector—rapid but fragile growth

In 2002 real GDP growth was high, at 9.9%

The economy remains vulnerable to adverse climatic conditions, as in 2000 when El Niño phenomena hurt agriculture. In contrast, in 2002 despite the global downturn and sluggish commodity prices, real GDP growth was high at an estimated 9.9% (figure 3.2), with agriculture growing at 14.4%. The high output was driven by favourable weather conditions rather than underlying sustained productivity growth, highlighting the low technology base of this key sector and the economy's vulnerability to future climatic shocks.

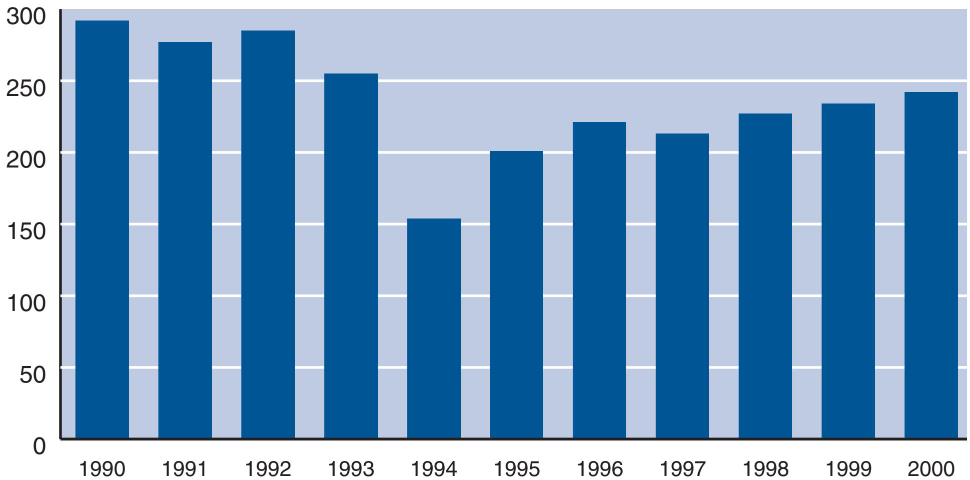
With robust agricultural growth, GDP in 2002 was supported by rapid expansion in construction, growing at 15%, partly the result of house-building by returnees. This growth may understate the true growth when informal activities are considered.

Structural diversification of the economy through the development of nonagricultural sectors has remained limited, and growth from this source is of minor significance. Agriculture, the main driver of growth (figure 3.3), is subsistence activity and has few links with other economic sectors. In 2002 manufacturing growth was 5%, down from 7.2% the previous year. Manufacturing remains beset by technological and skill constraints. Services grew by 4.5% in 2002, virtually unchanged from the previous year. The sector's growth has slowed since 1997, partly because of the gradual phasing out of emergency relief.

Figure 3.1

Genocide cuts incomes

GDP per capita, 1990–2000 (1995 US$)



Source: *Economic Commission for Africa, from official sources.*

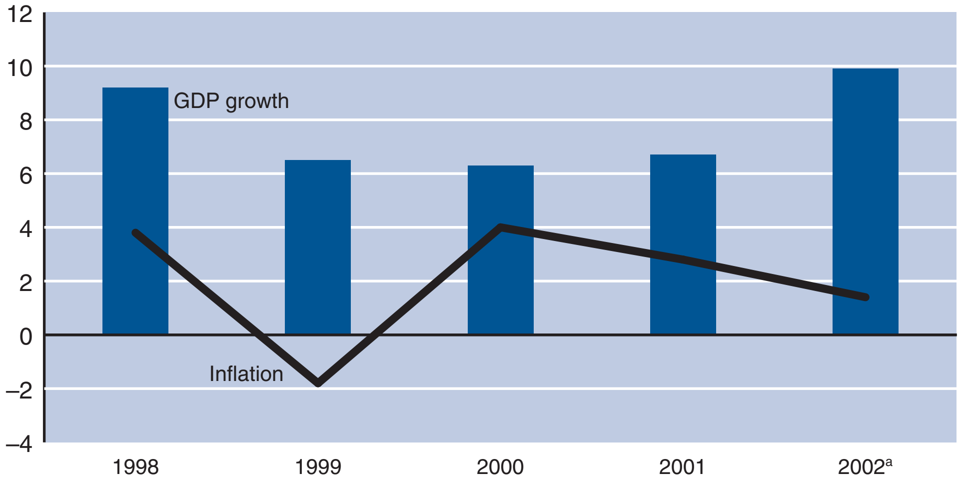
Fiscal policy—tensions between poverty reduction and macroeconomic stability

Rwanda's historical experience of civil conflict and genocide has generated structural biases in fiscal policy. In particular, spending patterns during the 1990s have tilted towards military and security expenditures to the detriment of outlays on infrastructure and social sectors (table 3.1). Following the genocide, the fiscal deficit fell as revenue levels recovered after productive sectors recommenced operations. But with limited domestic resources, Rwanda's fiscal position has remained in deficit, reaching 8.9% of GDP in 2000 and 9.5% in 2001 (figure 3.4) and is likely to reach 11% of GDP in 2002.

Figure 3.2

Strong growth with low inflation

GDP growth and inflation, 1998–2002 (%)



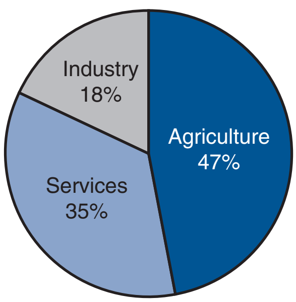
a. Estimated.

Source: *Economic Commission for Africa, from official sources.*

Figure 3.3

Agriculture—nearly half the economy

Sectoral shares in GDP, 2002



Source: *Economic Commission for Africa, from official sources.*

As Rwanda pushes forward with its Poverty Reduction Strategy, spending must be reoriented towards reconstruction and poverty alleviation. These include requirements arising directly from the post-conflict situation for spending on infrastructure and the rehabilitation of farming systems. Politically, reconciliation calls for spending on genocide

Table 3.1

Fiscal position, 1996–2001 (US$ millions)

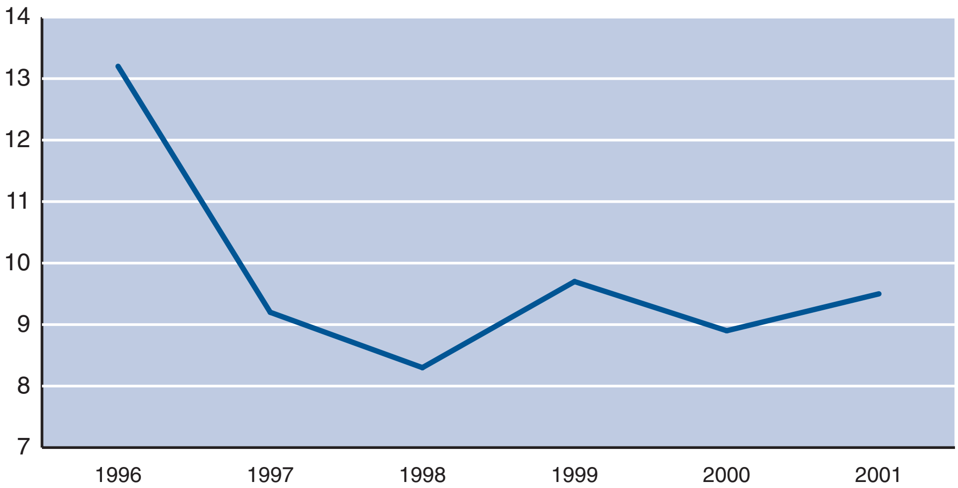
	1996	1997	1998	1999	2000	2001
Total revenue	128.4	192.1	208.2	190.5	176.3	194.6
% of GDP	9.3	10.4	10.6	9.9	9.7	11.4
Tax revenue	118.0	181.5	197.5	180.9	167.6	179.5
Nontax revenue	10.4	10.3	10.7	9.6	8.5	15.1
Total expenditure and net lending	310.6	362.4	370.3	378.6	338.0	356.9
% of GDP	22.5	19.6	18.9	19.6	18.7	21.0
Current expenditure	182.2	211.6	237.5	257.6	228.9	242.4
Education	21.5	32.4	35.0	51.5	61.6	67.3
Health	4.6	5.0	8.2	9.9	9.8	11.5
Agriculture	2.3	2.0	3.2	3.6	2.8	3.8
Defence	73.7	77.1	85.8	80.9	66.2	64.6
Capital expenditure	128.4	152.4	133.4	122.2	107.8	112.9
Budget deficit	–182.2	–170.6	–162.1	–188.1	–161.9	–162.3
% of GDP	13.2	9.2	8.3	9.7	8.9	9.5

Source: *Economic Commission for Africa, from official sources.*

Figure 3.4

Fiscal deficit down—but now on the rise

Budget deficit, 1996–2001 (% of GDP)



Source: *Economic Commission for Africa, from official sources.*

trials and on demobilization and reintegration. These special circumstances come on top of the needs in health, education, and agricultural modernization and the broader requirements of economic diversification, putting pressure on the fiscal deficit.

Rwanda's creditors have argued for any unavoidable extra expenditure to be financed by grants rather than concessionary finance because of Rwanda's HIPC status. But the savings from the HIPC Initiative have so far been limited. So, in the medium term Rwanda is unlikely to meet its HIPC targets. And its fiscal constraints will require further external inflows, some likely in loans rather than grants. This tension illustrates the problems with the HIPC Initiative's underlying design, especially its impact in Rwanda's special circumstances (box 3.3).

"Savings from the HIPC Initiative have so far been limited"

Resource constraints. Rwanda's growing expenditure needs exceed its domestic resources and aid flows, which fell from $110 per capita in 1995 to $45 by the end of the 1990s. Cash crops and (undeveloped) manufacturing are the main sources of domestic revenue, reduced by war and genocide. Agricultural revenues remain vulnerable to poor weather. In addition, population displacement has greatly disrupted agriculture and thus economic activity and revenue. Other post-conflict countries—with revenue more dependent on capital-intensive sectors, such as oil and mining—are less affected by population movements (Ndikumana 2001). In addition, political and social unrest led to a slump of 78% in tax volumes in 1994 (World Bank 2002). Revenues have since recovered to prewar levels.

A further structural problem is tax leniency, with loopholes and poor enforcement, thanks to political patronage and clientelism. Progress on this front will require building a more transparent bureaucracy and a strong state. Tariff-cutting commitments as part of the Common Market for Eastern and Southern Africa (COMESA) are also likely to put pressure on revenues.

Given these problems, the government is trying to improve revenues. A value-added tax (VAT) has been introduced, and tax enforcement strengthened. And strong growth in 2001, driven by agriculture and mining, also supported revenue. But even moderate success in these revenue-raising initiatives is unlikely to close the gap with expenditures. In the long term higher revenues can come only from sustained growth and economic diversification.

Fiscal deficit sustainability. The likely deficit of 11% of GDP in 2002 was higher than the 9.9% target because of demobilization costs incurred with the Rwandan army's withdrawal from the Democratic Republic of Congo. This expansionary fiscal stance sparked robust debate with the IMF about the sustainable deficit level, a key issue during the recent talks for renewing Rwanda's Poverty Reduction and Growth Facility. With the holdup in negotiations, several donors delayed their disbursements. An eventual compromise was reached between the Rwandan government and the IMF, with a projected deficit of 9.4% of GDP agreed for 2003. After the negotiations, extra expenditures for the forthcoming election, the health sector, and roads were included in the 2003 budget, now likely to take the deficit beyond that agreed with the IMF.

The Poverty Reduction Strategy sets out three scenarios for future spending: high, medium, and low. The spending plans agreed under the negotiations with the IMF appear to correspond broadly to the low scenario, and the extra expenditure introduced in the 2003 budget will push the fiscal deficit beyond the level set out in this scenario—to around 11% of GDP.

"Concerns about extra spending relate to macroeconomic stability and financing"

Concerns about the extra spending relate to macroeconomic stability and financing. Possible macro effects include inflationary pressure and the blunting of export incentives by external revenue inflows. But such risks must be considered in Rwanda's context (box 3.4). Too great an emphasis on fiscal targets can be misleading: the composition and quality of expenditure and the likely effects on long-term growth and poverty reduction can

Box 3.3

HIPC Initiative's flaws and the post-conflict context

For many African countries, including Rwanda, the HIPC Initiative is not providing the "exit" from unsustainable debt needed to meet the Millennium Development Goals. Rwanda has the added complication of its post-conflict context, starkly illustrating some of the HIPC Initiative's defects.

A key criticism of the HIPC Initiative is that its indicators of underlying debt sustainability are flawed. Much of the sustainability analysis by the World Bank and IMF is based on rather optimistic assumptions about future economic performance, the external environment, and the extent of projected financing needs. Rwanda illustrates each of these problems. There are huge risks to optimistic GDP growth projections of at least 6% over 2000–10. The external environment is likely to remain unfavorable, with declining coffee prices. And financing needs will continue to be great because of the post-conflict context.

An alternative to the HIPC criteria would be to link debt relief to a proportion of revenues needed for essential spending, possibly with different limits for different groups of countries. African leaders under the New Economic Partnership for Africa's Development have advocated this approach. In a similar vein, new proposals put forward in the U.S. Congress would add criteria to the HIPC framework. For example, countries suffering an HIV/AIDS crisis would put aside no more than 5% of their revenues for debt servicing. A similar approach could also be adopted for post-conflict countries. It has also been suggested that HIPC needs to take greater account of external shocks. This reflects the critical role of declining terms of trade in the buildup of debt, an issue previously neglected.

Rwanda's expenditure requirements in its post-conflict context raise issues about the HIPC process. First, the spending needs of post-conflict reconstruction and reconciliation will be essential to future social stability and so are particularly critical. A larger resource envelope may reduce the likelihood of future conflict by allowing more broad-based spending, helping to calm social grievances. Second, much of Rwanda's debt was accumulated under a regime that presided over the genocide. This suggests an application of the "doctrine of odious debt". The current regime should not be held accountable for debts resulting from earlier external inflows propping up an administration intent on widespread killing.

Source: *Birdsall and Deese 2002; Nissanke and Farrarini 2001; Addison and Murshed 2001; Ndikumana and Boyce 1998; Browne 2001.*

differ markedly across countries. For Rwanda much of the proposed extra spending is to meet the needs of a society emerging from conflict. Implementing such a program will pose enormous challenges, but if the program is sound, implementation would be justified on political, economic, and social grounds.

The effects on inflation will depend on patterns of spending and on how the extra spending is financed. And the biggest constraints to exports are not price distortions—they are the technical backwardness of export sectors and the history of poorly executed investments.

Monetary policy has been geared towards price stability

Monetary policy and the financial sector

Monetary policy, fairly successful in recent years, has been geared towards price stability. The government has also focused on the banking sector, especially on establishing a sound regulatory framework for credit delivery.

Prices and monetary policy. Prices have remained relatively stable, with inflation estimated to have stayed under 3% in 2001 and 2002 (see figure 3.2). Because the economy is largely nonmonetized and based on subsistence agriculture, inflation is heavily influenced by output in the agricultural sector. With a favourable climate, strong growth in agricultural output helped to stabilize prices. In addition, the National Bank of Rwanda has intervened to stem fast liquidity growth. So, despite a depreciating exchange rate in 2002, inflation remained tamed, with prices actually declining in the 12 months ending April 2002 (figure 3.5).

But prices have since assumed an upward trend, partly the result of increasing the VAT from 15% to 18%. Higher international oil prices, downward movements in the exchange rate, and the VAT increase have also pushed up the retail price of gasoline between January and September 2002, so transport costs could put pressure on food prices. Also contributing was 10% growth in broad money between December 2001 and July 2002, driven partly by private sector credit, with commerce accounting for the largest share of the increase and agriculture the least (figure 3.6). This higher liquidity was paralleled by declines in interest rates, with commercial bank lending rates falling

Box 3.4

Fiscal policy after conflict

The resources required for the expenditures under the higher Poverty Reduction Strategy scenarios are unlikely to be available. But there are clear economic reasons for the moderate increases in spending. Nor can macroeconomic sustainability be divorced from political sustainability, particularly given Rwanda's recent history. The legacy of violence must be considered, especially in the light of evidence suggesting that a strong predictor of civil violence is the previous occurrence of such violence. The needs of social and political reconciliation are therefore critical. A macroeconomic program that does not address these issues could be extremely dangerous.

Source: *Economic Commission for Africa, from official sources.*

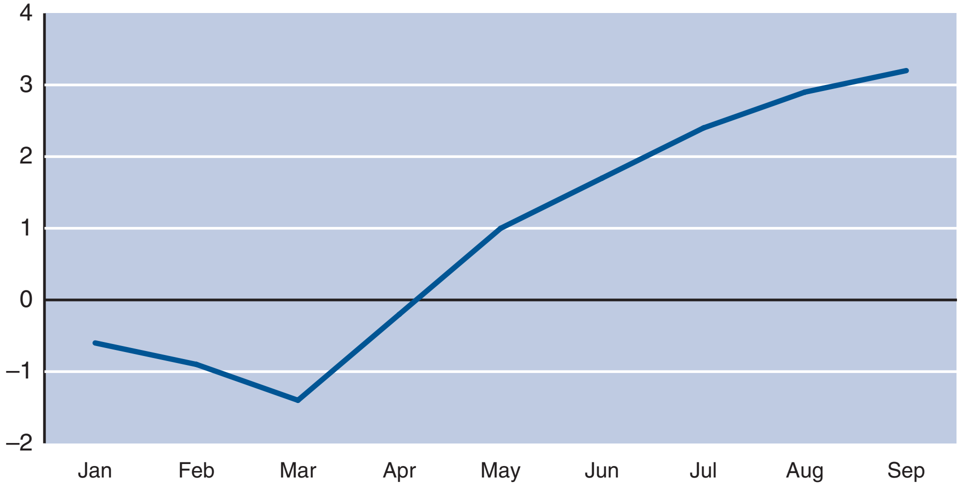
from 17.3% in December 2001 to 15.0% by August 2002, reflecting more liquidity in the banking system and greater competition among banks.

The loosening of the monetary stance was also the result of central bank financing of government operations, increased by the delay in donor disbursements. After May 2002

Figure 3.5

Inflation spikes in 2002

Consumer prices, 2002 (year-on-year percentage change)

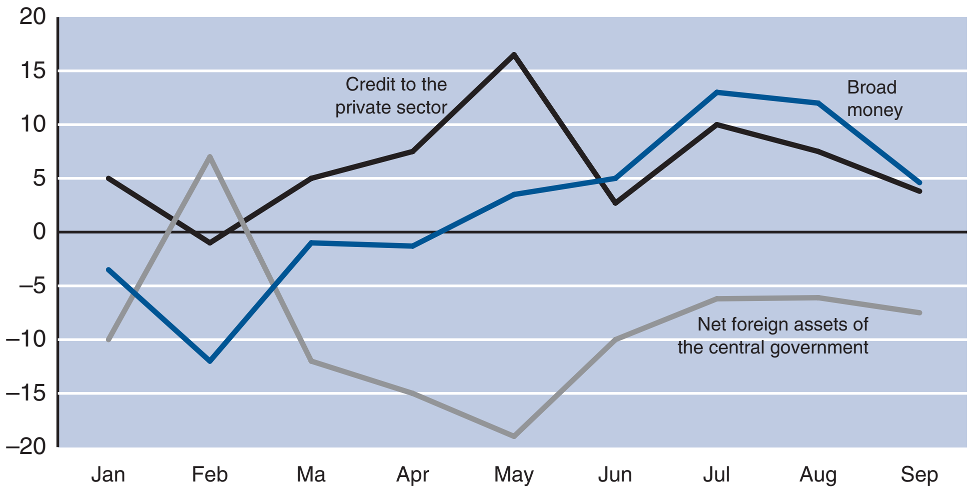


Source: *Economic Commission for Africa, from official sources.*

Figure 3.6

Credit to the private sector leads monetary growth

Contributions to monetary growth, 2002 (percentage change)



Source: *Economic Commission for Africa, from official sources.*

the National Bank of Rwanda acted to stem this liquidity increase with money market interventions and new government securities, leading to a 6.1% decline in broad money between July and September 2002, part of a continuing trend away from direct to indirect instruments of monetary policy.

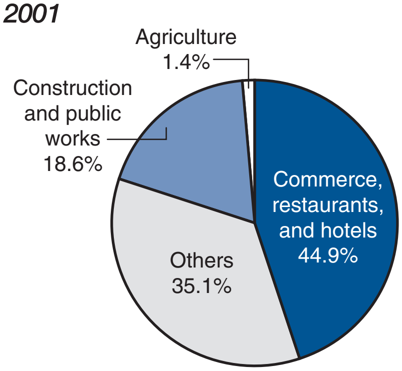
The banking sector—weighed down by bad loans. Of nine commercial banks in Rwanda, five were established after 1994. All remain conservative in their range of services and cautious in lending activities. The sector's performance is hobbled by the huge portfolio of nonperforming loans, some 40% of the total portfolio at the end of 2001 (IMF 2002a). These accumulated because of lax supervisory controls, economic instability, and road tonnage limits imposed on Rwandan trucks by the Kenyan government, hurting trade and transport. An important barrier to restoring the banks' financial soundness is the lack of legal provisions for claiming the collateral assets of defaulting firms. Bank lending to the private sector remains heavily constrained, with lending rates staying high to counter the risk of loan default.

> *"Bank lending to the private sector remains heavily constrained"*

To deal with these problems, the government is establishing a sound legal and regulatory framework for credit delivery. The National Bank of Rwanda is working with the Ministries of Finance and Justice and the bankers association to find ways of improving loan recovery. An action plan detailing specific steps was completed in December 2002. The National Bank of Rwanda is also strengthening its supervisory role over commercial banks and improving its regulatory framework. It is also strengthening its risks and unpaid debts unit to improve the quality of credit information. Several commercial banks are being restructured, with some sell-offs planned.

Credit issues—access skewed and generally limited. Bank lending is concentrated in commerce and construction (figure 3.7), with agriculture getting less than 2%, despite its importance. There are institutional constraints to lending to this sector, as the rural economy is largely noncommercialized. Difficult to acquire, credit remains largely short

Figure 3.7
Agriculture—not being financed
Sectoral shares in credit, 2001



Source: *Economic Commission for Africa, from official sources.*

term. Retail banking is limited to richer households, and poor households are unlikely to have access to the formal financial sector. The Poverty Reduction Strategy thus includes provisions for expanding microcredit facilities and devising a legal and regulatory framework for microfinance. In addition, the *banques populaires* are being recapitalized to facilitate the expansion of credit to farmers.

“Rwanda’s trade and current account balances have remained in deficit”

External sector

Rwanda’s trade and current account balances have remained in deficit over the last two years (table 3.2). The main reason is the narrow export base of cash crops along with colombite-tantalite (coltan), leaving total values vulnerable to the vagaries of international commodity prices (figure 3.8). In addition, the country’s landlocked position generates high transport costs, pushing the services account into deficit. The country has depended on aid flows to fund its external imbalances, building up external debt.

The recent global slowdown drove down prices of nonoil commodities, including coffee and tea, which provide more than 80% of Rwanda’s export earnings. After rising 14% in 2001, exports of crops slipped 0.4% in 2002. Coltan prices also slumped in 2002, further depressing export values. For January–September 2002, exports were $49.4 million, down 39% from the same period in 2001, when there was a short boom in coltan exports. The sharper reductions in value than in volume show the effect of declining international prices (table 3.3). Imports have fallen slightly over 2002 as a result of reduced food imports, but the decline in value terms is far less than that of exports. Rwanda’s trade balance is likely to have remained in deficit over 2002, with the deficit to September totaling $131.6 million, a slight decrease from the same period the previous year.

Exchange rate trends. Floated in 1995 the Rwandan franc has depreciated gradually, moderated by exchange market interventions by the National Bank of Rwanda. Through September 2002 the lower exports and the delays in foreign aid disbursements led to a

Table 3.2

Balance of payments, 1999–2001 (US$ millions)

Item	1999	2000	2001
Exports	62.0	89.8	93.3
Imports	248.8	239.8	255.2
Trade balance	–186.7	–150.1	–161.8
Services balance	–154.4	–156.8	–139.0
Transfer balance	198.3	216.6	190.7
Current account balance			
Including official transfers	–142.9	–90.2	–110.2
Excluding official transfers	–323.0	–295.8	–279.2
Excluding official transfers (% of GDP)	–16.7	–16.3	–16.4

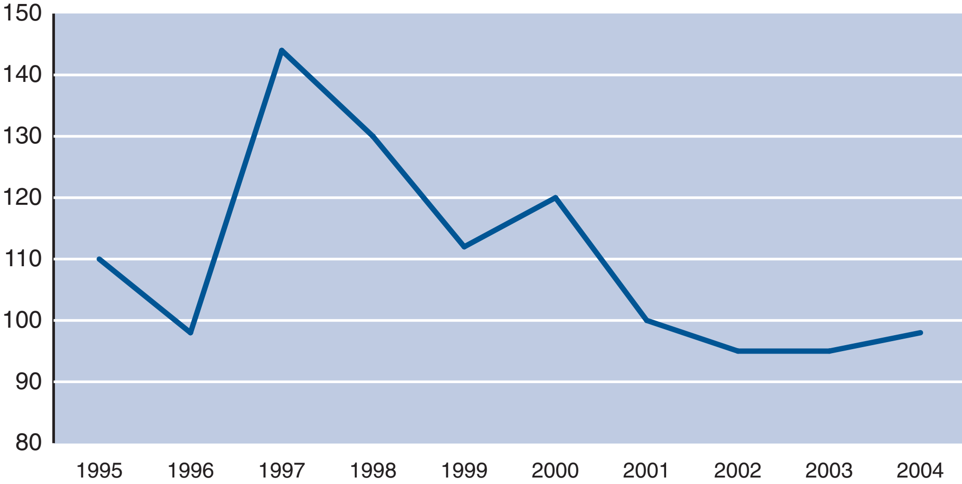
Source: *Economic Commission for Africa, from official sources.*

foreign exchange shortage of $51 million, eroding reserves, still equivalent to more than five months of imports. Against the dollar, the franc depreciated by 2.6% from the end of 2001 to the end of June 2002, continuing recent trends. So far this has not led to serious inflationary pressures, thanks to good harvests and prudent monetary policies. And the introduction of foreign exchange auctions has increased the transparency of the National Bank of Rwanda's open market operations.

Figure 3.8

Collapsing terms of trade

Terms of trade, 1995–2004 (2001 = 100)



Source: *Economic Commission for Africa, from official sources.*

Table 3.3

Export values and volumes

Export	Jan–Sept 2001	Jan–Sept 2002	Change (%)
Total export value (US$ millions)	80.7	49.4	–38.8
Coffee			
Value (US$ millions)	17.2	12.1	–29.8
Volume (tons)	15,517.2	15,742.3	1.5
Tea			
Value (US$ millions)	19.1	17.2	–10.2
Volume (tons)	12,584.0	11,886.3	–5.5
Coltan			
Value (US$ millions)	38.1	12.8	–66.4
Volume (tons)	1,240.0	961.4	–22.5

Source: *Economic Commission for Africa, from official sources.*

External flows and the debt stock. Given the long-standing deficit on the current account and the limited potential for private financing as a HIPC, Rwanda depends on official flows to close its financing gap. In 2001 official transfers constituted around 58% of foreign exchange receipts, equivalent to around 60% of the current account deficit. Over time these inflows have built up the stock of external debt, to $1.3 billion at the end of 2001, most of it concessionary (table 3.4).

Rwanda is unlikely to meet its HIPC targets in the medium term

Under the HIPC Initiative the net present value of the debt stock in 2001 was reduced to 180% of the value of exports, for a $25 million saving (table 3.5). Previously Rwanda's debt had been paid from an international trust fund, discontinued under the terms of the HIPC Initiative. So in 2001 the actual savings to the Rwandan government was only $4.5 million (this is expected to increase in the medium term). The HIPC Initiative has thus made a negligible contribution to progress on poverty reduction targets. With an ongoing need for external financing because of pressing expenditure requirements, Rwanda is unlikely to meet its HIPC targets in the medium term (see box 3.3).

Table 3.4

External debt, selected years (US$ millions)

External debt	1997	2000	2001[a]
Total external debt outstanding	1,138.0	1,305.0	1,316.0
Multilateral	927.4	1,137.1	1,169.4
International Development Association	557.5	723.5	714.8
International Monetary Fund	40.4	85.8	84.3
Bilateral	201.4	167.4	145.9
Paris Club	93.7	73.1	74.2
Non–Paris Club	107.7	94.3	71.7
Commercial	9.1	0.6	0.6
Total debt stock (% GDP)	61.6	72.1	77.3

a. Estimated.

Source: *Economic Commission for Africa, from official sources.*

Table 3.5

Debt service savings from the HIPC Initiative, 2001–04 (US$ millions)

Item	2001	2002	2003	2004
Debt service due before HIPC	46.72	46.19	50.66	61.49
Debt service due after HIPC	22.06	11.25	9.23	15.5
Total HIPC saving	24.67	34.94	41.43	45.99
Accruing to Rwanda	4.45	12.05	16.76	19.36
Accruing to donors through multilateral fund	20.22	22.88	24.67	26.63

Source: *Economic Commission for Africa, from official sources.*

Institutional reforms

Key institutional changes include reform of the centralized bureaucracy, with fiscal decentralization, and privatization focused on development objectives.

Decentralization

A key plank of institutional reform is the decentralization program aimed at reforming the centralized and hierarchical state bureaucracy. A decentralization law was passed in 2001, setting up various tiers of government, including 11 provinces along with the city of Kigali, 106 districts, and many subdistrict *cellules*. The Common Development Fund, established to allocate funds to district programs, will eventually take 10% of central government revenue. And with decentralization of revenue accompanying decentralization of expenditure functions, regional governments will be able to raise some of their income from local sources. The reform program is also harnessing *ubedehe*, promoting community cooperation and the collective articulation of needs. It is envisaged that cellule-level planning will eventually be integrated into broader medium-term expenditure framework processes.

> *Decentralization does not automatically enhance pro-poor service delivery*

Two motives drive the initiatives. First, decentralized systems of government are believed to promote efficient service delivery. Second, decentralization is seen as a tonic to the predatory centralized regime that presided over the genocide. In the runup to the 2003 presidential and parliamentary elections, the current regime needs to be seen as building the beginnings of more participatory institutions. Decentralization is also linked to processes of reconciliation, as embodied in *gacaca* (box 3.5). Institutional reform is thus essential for future stability (boxes 3.6 and 3.7). The reforms are therefore being driven more by political than economic or administrative necessity. The enabling legislation has moved forward faster than the growth in local administrative capacity to implement the program.

With resources susceptible to capture by local elites, decentralization does not automatically enhance pro-poor service delivery (Crook and Sverrisson 2001). The direct economic benefits of decentralization need to be justified by local politics and local administrative capacities. Attempts are being made to integrate lower tiers of government into the broader planning frameworks now being created. But the lack of local capacity could make it difficult to establish more strategic and comprehensive approaches to expenditure and budgeting, such as sectorwide approaches and medium-term expenditure framework initiatives.

Private sector development and privatization

Many privatizations under the 1996 privatization law were essentially liquidations of nonfunctioning state-owned enterprises, mainly from the agro-industrial sectors, whose physical and human assets had been damaged or destroyed in the civil war. Only now is the privatization initiative bringing developmental objectives to the fore. A privatization secretariat has been set up to support the program, and a regulatory agency established to set tariffs, grant licenses, and prevent companies from acting as private monopolies.

Box 3.5

Gacaca mechanisms for social reconciliation

In 1996 the government passed a law to prosecute people suspected of genocide-related crimes committed during 1991–94. Resolution of the large number of cases was slow, and full settlement was predicted to take a century. Around 107,000 people remain in prison, most of these held in connection with the genocide.

To expedite prosecution, the government has set up *gacaca* courts based on traditional community institutions of dispute resolution. Suspects will be tried in front of the communities in which crimes were committed. The tribunals will not deal with the most senior organizers of the genocide, who are to be tried by the UN's International Criminal Tribunal for Rwanda, based in Arusha, Tanzania.

For gacaca suspects who admit their crimes, sentences will be reduced. Because many have already been in custody for a number of years, this will lead to their release and return to their communities. The process is premised on collective forgiveness as a first step to rebuilding communities and achieving social stability through the rehabilitation of trust (figure 1).

Recent social research has shown the ongoing social and psychological legacy of the genocide in terms of lack of trust. The success of the initiative depends on widespread awareness of the process across all social groups (figure 2).

Figure 1

People who perceive trust as a major social problem, by genocide experience

(% of population)

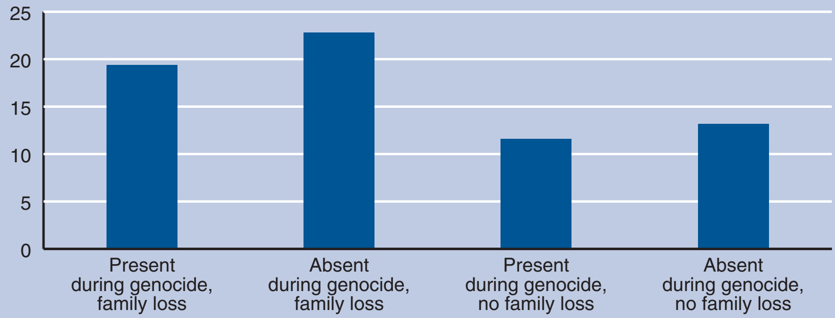
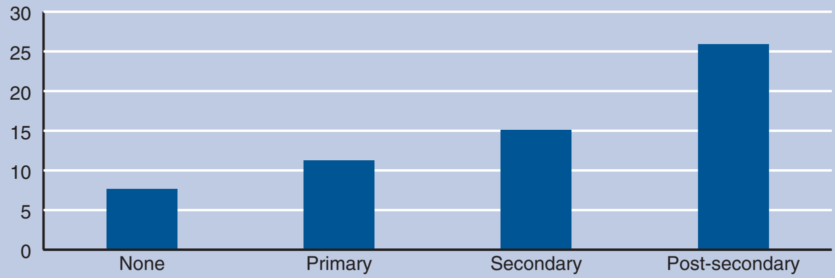


Figure 2

People with good knowledge of *gacaca*, by education

(% of population)



Source: *Economic Commission for Africa, from official sources; Gabisirege and Babalola 2001.*

The sale of the telephone operator, Rwandatel, should be concluded by the end of 2003, with 55% to a strategic investor, 5% to employees, 1% to the government, and the rest to other investors. Electrogaz, the water and electricity provider, will remain in state ownership, with its management privatized through a long-term management contract. The other main sector for privatization is tea. Two of the nine factories are slated for sale as part of a pilot.

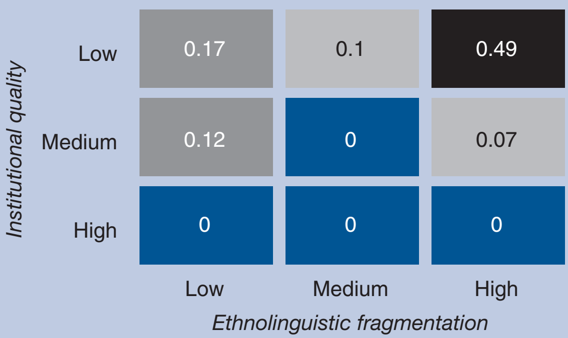
Box 3.6
Strengthening institutional quality—the key to stability

The ethnic and linguistic fragmentation of societies has been used by several economists to explain Africa's poor growth, the outbreak of civil war, and the occurrence of genocide. Recent research finds that the probability of genocide increases when countries are more ethnically fragmented. But this effect is found only for countries with low-quality institutions, nontransparent bureaucracies, and poor contract enforcement. Ethnically fragmented countries with poor institutions, such as Angola, Nigeria, and Sudan, are thus at a markedly higher risk of genocide.

In ethnically fragmented countries with high-quality institutions, such as Canada, Malaysia, and Thailand, the negative effects of ethnic fragmentation disappear. Certain ingredients of a good institutional structure—such as efficient bureaucratic procedures, freedom from government expropriation, and the rule of law—may provide avenues for the peaceful settlement of distributive conflicts between ethnic groupings.

But other models suggest very different effects from ethnic fragmentation. The data used to generate these sorts of statistical results are extremely unreliable in conflict-affected countries. The use of econometric techniques has also been criticized for oversimplifying the complex social, political, and economic dynamics surrounding conflict. Even so, the results suggest the importance of institutional strengthening in conflict-affected countries such as Rwanda. The building of an inclusive and nonpartisan state bureaucracy is likely to be essential to future stability.

Fragmentation, institutions, and genocide
Probability of genocide



Source: *Easterly 2001; Collier and Hoeffler 1998; Cramer 2002.*

Privatization appears to have political support because of the limited capacity of the state to revitalize firms. But buyer interest has been slight, partly the result of the poor shape of assets and human resources in many of the firms being sold. And in the runup to sell-offs, the government has had little incentive to invest in ailing enterprises. A key challenge is putting in place the institutional mechanisms for the effective regulation of privatized firms.

Government spending on the social sectors lags behind that of Sub-Saharan African countries

Social sectors

Government spending on the social sectors in Rwanda lags behind that in other Sub-Saharan countries, crowded out by military spending of 24.4% of GDP in 1992–97, more than twice the Sub-Saharan average of 11.5%. Strengthening education and health is a key priority in the Poverty Reduction Strategy.

Education—improving outcomes and equity

In 1992–97 Rwanda's education spending amounted to 3.3% of GDP compared with 4.9% for Sub-Saharan Africa (Ndikumana 2001). Recent improvements in key indicators reflect a gradual increase in the share of education in total expenditure from 12% in 1996 to 24% in 2001 (IMF 2002a).

- The gross primary enrolment rate improved from 88% in 1999 to 97% in 2000, and is now estimated at 100%. But the quality of primary and secondary education is

Box 3.7

Institutions, ethnicity, and reform

Rebuilding the capacity of the civil service is critical for putting in place the technical and administrative prerequisites for achieving the targets in *Vision 2020* and the Poverty Reduction Strategy. Previous regimes have used civil service appointments as tools of political patronage to bolster support from some ethnic groups. In the post-colonial period discriminatory practices in state employment fostered Hutu domination of the public sector. Such biases can heighten feelings of exclusion among some groups. In the early 1990s structural adjustment and privatization policies inadvertently implied a reversal of these long-standing biases. By rolling back the state and promoting the private sector, these reforms appeared as a threat to Hutu elites in favor of the Tutsis, traditionally perceived to dominate the private sector. The genocide has been interpreted by some as a last ditch attempt by these threatened groups to maintain their hold on power and privilege.

True, the causes of the genocide are complex and multiple. But the application of one size fits all policy prescriptions to this volatile situation may have been unwise. At an international level, future donor policies in institutional reform must be sensitive to underlying social realities. And as the Rwandan state seeks to build its legitimacy, it must be seen to be impartial towards the different social groups, especially in the current drive towards a meritocratic and transparent civil service.

Source: *Economic Commission for Africa, from official sources.*

low, evident in literacy rates of 48% for women and 58% for men (Rwanda, Ministry of Finance and Economic Planning 2002a).

- Transition rates from primary to secondary levels are low, and dropout and repetition rates at the primary level remain high. Only 7% of the population over 15 years old has a secondary education, and only 0.4% a tertiary education.
- Educational attainment also has a clear income dimension, with only 15% of the poorest fifth of the population completing primary education, compared with 53% for the richest fifth (Rwanda, Ministry of Finance and Economic Planning 2002a).
- Fewer than half of teachers are adequately trained.
- The education system does not equip students with the skills needed for the labour market.

"The quality of primary and secondary education is low"

To begin addressing these needs, skills-oriented colleges have been set up, such as the Kigali Institute of Science and Technology. Vocational courses are to be promoted in secondary schools, and the school curriculum is to be reviewed (box 3.8).

Health—improving access

In 1992–98 Rwanda's per capita expenditure on health averaged just over $9, less than a quarter of the $38 average for Sub-Saharan Africa. The country fares slightly better in health expenditure as a percentage of GDP, with an average of 4.2%, compared with 3.9% for Sub-Saharan Africa (World Bank 2002). And share of health in total expenditure increased from 1.4% in 1996 to 5.1% in 2001. But on several health indicators, Rwanda lags behind the Sub-Saharan average.

- Child mortality rose sharply during the genocide, and although falling later, it remains significantly above the pre-genocide rate and high by African standards (figure 3.9).
- Life expectancy, at 40 years, is still significantly worse than the Sub-Saharan average of 49 years.

Box 3.8

The sectorwide approach in education

In planning and policy management, education is a key area where the shift from an emergency response to a development focus has begun to be institutionalized. The sector is the first to put in place a sectorwide approach aimed at strategically integrating all projects relating to education and orienting them towards the goals of the Poverty Reduction Strategy and *Vision 2020*. This process has resulted in a strategic plan for 2003–08, devised by the Ministries of Education and Gender, local governments, donors, NGOs, and other bodies. The sectorwide approach should guide the education sector's input into the medium-term expenditure framework and provide an early indication of the challenges likely to be faced as the approach is applied in other sectors.

Source: *Economic Commission for Africa, from official sources.*

- HIV/AIDS prevalence of 8.9% in 2001, though well below those in southern Africa and below the African average of 10.3%, is on the rise. So, HIV/AIDS could hurt long-term growth and development prospects.

Use of health services has fallen in recent years

Causes of ill health include limited access to health services, a result of low income, poor information, and little education, as well as limited access to clean water. Malaria and malnutrition have also been major contributing factors. There is also a critical shortage of key health workers, with only 1.8 doctors per 100,000 inhabitants, particularly in rural provinces (EIU 2002).

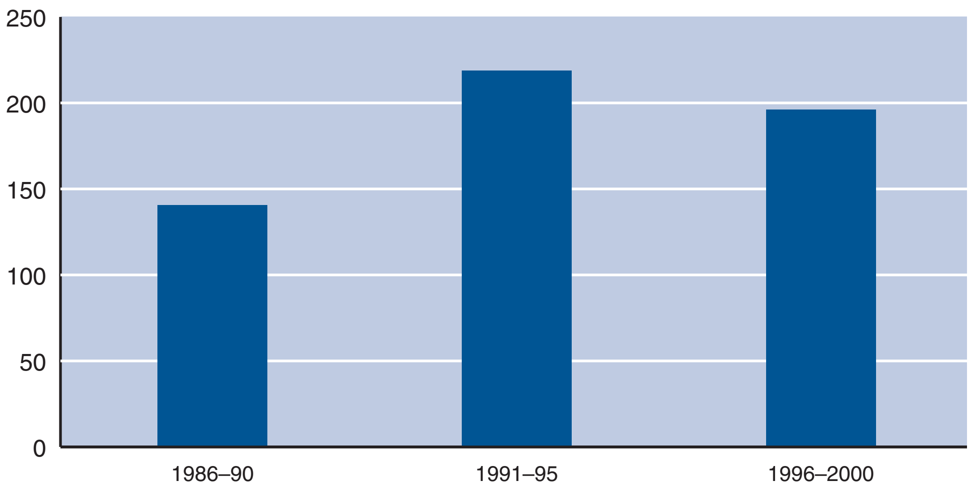
Use of health services, already low, has fallen in recent years, with the number of new cases per inhabitant entering the health system annually falling from 0.34 in 1998 to 0.26 in 2000. Cost appears to be a major constraint. In the Core Welfare Indicators Survey 15% of respondents had been unwell in the month preceding the survey but had not used health services because of the cost (Rwanda, Ministry of Finance and Economic Planning 2001a). More than 20% of rural residents cite cost barriers, compared with 9% for the urban poor and 6% for the urban population overall. Only 8.8% of hospital patients were from the poorest fifth of the population, while 43% were from the richest fifth.

The Poverty Reduction Strategy aims to improve access to health care by reducing costs to the poor, enhancing information provision to communities, improving the quality of health services, and dealing with malaria and HIV/AIDS. Institutional mechanisms

Figure 3.9

Higher child mortality after genocide

Child mortality, 1986–90 to 1996–2000 (deaths per 1,000 children under five years old)



Note: *The data are derived from interviews with surviving mothers and do not include the deaths of children of mothers who died in the genocide. The figures are therefore likely to understate child mortality during the early 1990s.*

Source: *Economic Commission for Africa, from official sources.*

are being put in place to achieve these aims. For example, *mutuelle* health insurance schemes address cost, while in the *ubedehe* initiative community health workers at the cellule level improve information flows.

Poverty patterns and poverty reduction—violence intensifies the drivers of poverty

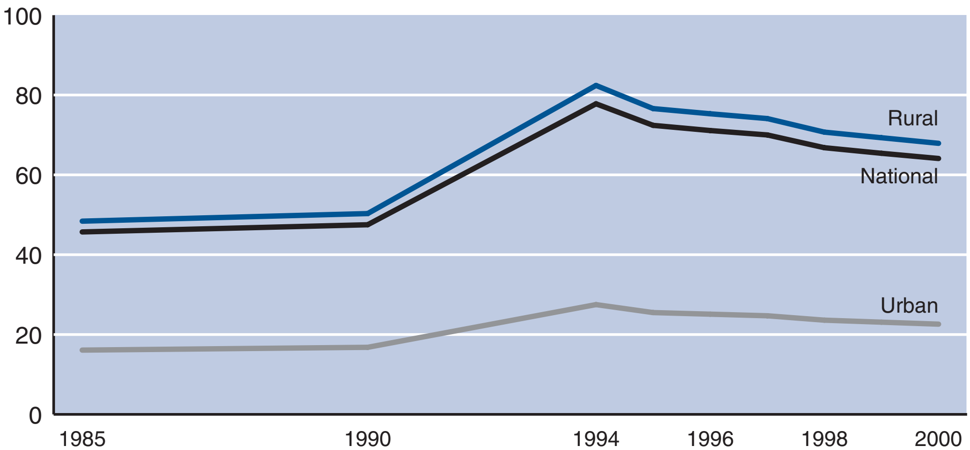
The number of households under the poverty line reached 53% in 1993 and jumped to 78% in 1994, with a clear rural-urban divide (figure 3.10). Although rapid postwar growth supported fast reductions in poverty, the levels remain well above those before 1994. Traditionally driving poverty were poor agricultural performance, limited non-farm employment opportunities, and low levels of skills, leaving households vulnerable to weather and terms of trade shocks.

> *"Poverty levels remain well above those before 1994"*

These factors were compounded by the genocide. Many households lost wage-earners and key assets, such as livestock. The number of female-headed and female-dominated households rose dramatically. By 1996 women headed 34% of households, and widows headed 21%. There are also some 85,000 child-headed households (Rwanda, Ministry of Finance and Economic Planning 2002a). Such households are economically vulnerable because of limited wage-earning opportunities and lack of access to land. And with the loss of adult male family members, household members are at greater risk of violence.

The transition to stability has generated waves of population movement, adding to social insecurity. Returning populations lack access to land and shelter (some 192,000 families remain without proper shelter). A villagization program has been initiated to resettle these groups. But the settlements lack basic infrastructure and access to

Figure 3.10
Poverty up sharply in 1994
Households under the poverty line, by urban and rural location, 1985–2000 (%)



Source: *Economic Commission for Africa, from official sources.*

healthcare and education. All these factors disrupt income streams and survival strategies, exposing households to considerable vulnerability.

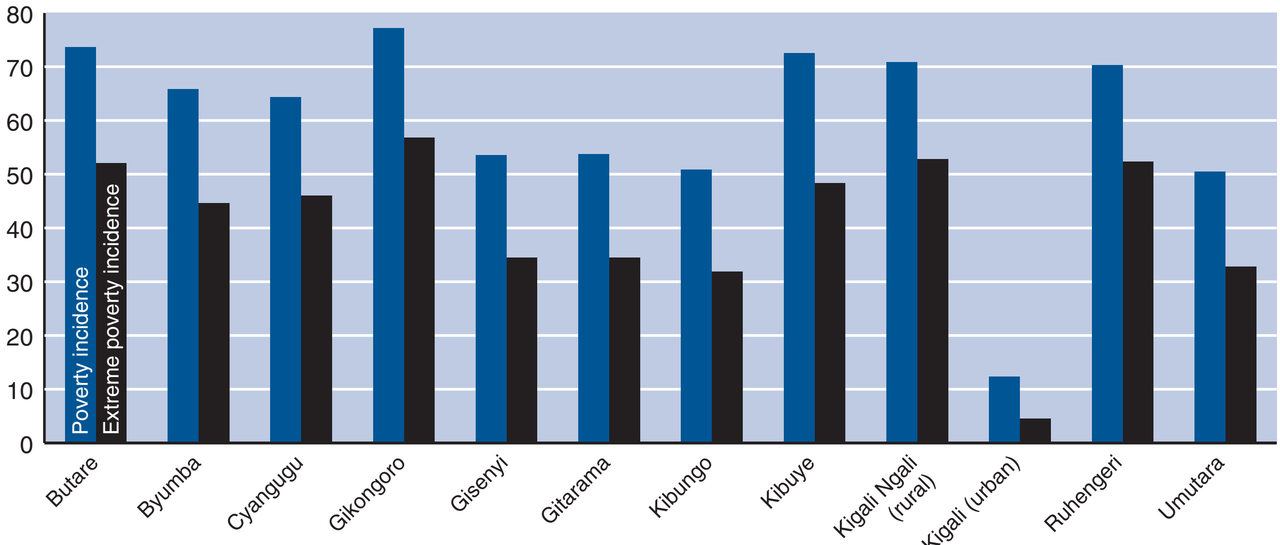
Urban Kigali has much lower levels of poverty than rural areas (figure 3.11). A range of problems face outlying regions. In the southern province of Butare, population pressure and low agricultural investment have contributed to declining soil quality—and the region has the highest proportion of widow-headed households, at 28% (Rwanda, Ministry of Finance and Economic Planning 2002a). In Gisenyi in the northwest—an area traditionally advanced in agriculture, with comparatively high fertilizer use—insecurity and the destruction of infrastructure have severely reduced access to markets. Coping strategies there are leading to further environmental and soil degradation. The province with the widest and deepest poverty, Gikongoro in the south, is densely populated, and households have depended on migration to other areas. But heightened insecurity has disrupted this traditional source of income, pushing 77% of households into poverty and 57% into extreme deprivation by 2001.

"Urban Kigali has much lower levels of poverty than rural areas"

The framework for poverty reduction

Poverty in Rwanda stems from underlying structural problems and the debilitating effects of extreme violence. Efforts to reduce poverty must address purely economic problems but will have to do so within the context of dealing with the political and historical legacies. The spending requirements of social reconciliation and related processes of decentralization and demobilization have a central place in the Poverty Reduction Strategy. In addition, the strategy sets out a number of key priority areas

Figure 3.11
High rural poverty rates
Poverty by region, 2001 (% of households)



Note: *Extreme poverty refers to households falling below the food poverty line.*
Source: *Economic Commission for Africa, from official sources.*

aimed at cutting poverty to less than half the 2001 level by 2015, including rural modernization and human development (box 3.9).

The objectives in the Poverty Reduction Strategy are extremely demanding, particularly on institutional and financial capacities, but there has been little significant progress towards their realization. The Poverty Reduction Strategy framework has not had enough coordination and harmonization between donors. Nevertheless, the first stages of institutionalizing these goals in a medium-term expenditure framework have begun. Ministries have defined their priority areas through the Poverty Reduction Strategy to allow their integration into the more transparent budgetary framework (box 3.10).

> *Commercial agriculture faces low prices*

One problem with Rwanda's Poverty Reduction Strategy is inadequate coordination and streamlining by donors. Recent proposals to improve the Poverty Reduction Strategy framework are based on a more robust common framework for conditionalities between donors (see box 3.9).

Policy challenges in key sectors

The Poverty Reduction Strategy calls for modernization of the agricultural sector, where productivity is low. In industrial sectors, the effects of the genocide compound problems of low human capital and technology, high costs, and limited access to finance.

The agricultural sector—boosting productivity

Poor living standards and declining incomes are rooted in agriculture, which employs 90% of the workforce and is thus critical for living standards and poverty rates.

High rainfall and steep slopes encourage soil erosion, while management of this problem through terracing and planting hedgerows has not been completely effective (Clay and Lewis 1996). In addition, land scarcity and population pressure have changed the structure of landholdings, which in turn has affected land management (Clay 1996). Population pressure on scarce land has led to more farming on marginal areas and more renting of separated plots of land. This fragmentation has intensified cropping, without accompanying soil conservation investments, degrading soil and reducing yields.

With land now scarce, rising output will have to come from higher productivity through technological improvements in fertilizers and soil conservation. Chemical fertilizer usage is low, only 3% of cultivated land in 2000 (Kelly and others 2001). One of the most serious constraints is farmers' lack of knowledge about fertilizer.

Commercial agriculture faces low prices and high costs. Output of Rwanda's main cash crop, coffee, fell by nearly 80% between 1990 and 2001, with prices approaching the point where farmers abandon their coffee trees or even uproot them (Loveridge, Nyarwaya, and Shingiro 2002). Such disinvestment does not bode well for the capacity of producers to take advantage of possible upturns in international prices. One proposal

Box 3.9

Rwanda's Poverty Reduction Strategy

Rwanda's Poverty Reduction Strategy, approved by the boards of the IMF and World Bank in August 2002, sets out the key requirements for reducing poverty within the country's broader development framework in *Vision 2020*. The main objectives:

Rural development and agricultural transformation. Measures to modernize farming techniques, improve farmers' knowledge, support off-farm employment, provide credit, improve rural infrastructure, and use labor-intensive rural public works.

Human development. Actions to improve health provision (including measures on malaria, HIV/AIDS, and family planning), skills and educational development, and water supply and resettlement.

Economic infrastructure. Measures to develop roads, energy, and communications, including energy provision to poor households and rural enterprises.

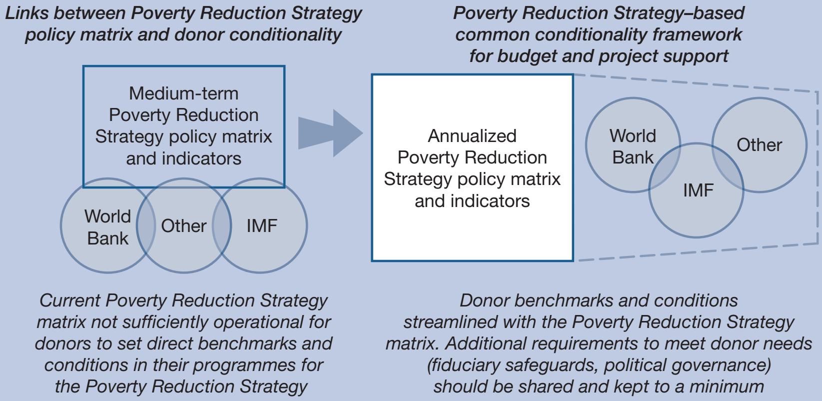
Governance. Measures on a host of related issues, including security and demobilization, reconciliation, decentralization, constitutional change, and civil service reform with the introduction of sectoral strategies and the use of more transparent and accountable procedures.

Private sector development. Measures to promote investment and export promotion, reform of the financial sector, privatization, and greater private sector representation.

Institutional capacity building and other cross-cutting issues. Given the loss of skills as a result of the genocide, measures to rehabilitate the capacity of institutions and put in place incentives to retain skilled personnel. Other cross-cutting areas are technology, gender, environment, villagization, HIV/AIDS, and employment.

Progress has been made in monitoring poverty, orienting expenditure to social sectors, and implementing the medium-term expenditure framework. But the government has also said that donor coordination and accountability need to be improved as the Poverty Reduction Strategy process progresses (see figure). In addition, donors and multilateral institutions remain prescriptive on policy approaches, despite the Poverty Reduction Strategy framework's gloss of "country ownership".

Moving to a common Poverty Reduction Strategy framework



Source: *SPA 2002; Economic Commission for Africa, from official sources.*

for reviving the sector is to upgrade quality and tap into premium and "fair trade" western markets (Loveridge, Mpyisi, and Weber 2002). But this would require considerable investments to improve washing and processing facilities.

Production of the other main cash crop, bananas, declined by some 70% over the last decade, partly because of reduced manure usage, lower government investment, and political instability (Donovan and others 2002). Because households engaged in cash cropping tend to have a lower incidence of poverty than those dependent on subsistence activities, the declines in cash crop outputs may have negative implications for household livelihoods.

The industrial sector employs less than 2% of the population

Solutions require integrated packages. The use of inorganic fertilizer must be combined with organic inputs along with land conservation, particularly in Rwanda's hilly terrain. Fertilizer use must be increased by enhancing farmers' knowledge and offsetting the risk of initial investments in inputs, especially when cultivators are at the bottom

Box 3.10

Institutional mechanisms to put poverty-oriented expenditures in place

Putting in place a medium-term expenditure framework and institutionalizing poverty-reduction objectives, the budgetary reforms have achieved certain objectives. But they still face constraints in the four principles underlying the approach:

Transparency. All ministries are now employing a strategic planning model linking activities with defined objectives. Provinces have been part of this model since 2002. This has aided transparency in the preparation of the budget and provided mechanisms for linking the budget with objectives in the Poverty Reduction Strategy. But in the execution of budgetary plans transparency has not yet been achieved in the linkage between funds requested under subprograms and the objectives used to define the budgetary allocations at the preparation stage.

Coordination. Important achievements have been made in linking the priority areas of the Poverty Reduction Strategy with the detailed spending allocations in the medium-term expenditure framework. Ministries have identified priority programs on the basis of the Poverty Reduction Strategy and integrated them into the process. But projects in individual sectors have not yet been generally integrated into sectorwide strategies. Such an approach would help to bring greater clarity of aims to the medium-term expenditure framework. Efforts in this direction have begun in education.

Comprehensiveness. Though improved, challenges remain in achieving a comprehensive and integrated budget. In particular, management of the development and recurrent budgets by separate parts of the bureaucracy causes problems. Preparation of the development budget has not been well integrated into the medium-term expenditure framework process.

Predictability. Fluctuations in external funding have implications for the predictability of revenues, especially in Rwanda's shaky macroeconomic environment. Because of the delay in donor disbursements as a result of the problems surrounding the Poverty Reduction Growth Facility negotiations, 2002 was a particularly bad year.

Source: *Economic Commission for Africa, from official sources.*

of their learning curves. And improvements in marketing infrastructures are sorely required in the form of better roads and information. The Poverty Reduction Strategy contains important provisions in these areas aimed at modernizing the sector, but attempts to push the necessary investments remain limited.

> *Industrial enterprises were badly hurt by the civil war*

Nonagricultural sectors—underdeveloped and lacking skills

The industrial sector remains weak and of marginal significance, employing less than 2% of the population and contributing only an estimated 18% to GDP in 2002 (Rwanda, Ministry of Finance and Economic Planning 2001b). Firms are small, with only 12 companies having more than 500 employees. Larger manufacturing enterprises are active mainly in beverages, tobacco, cement, textiles, and tea and coffee processing.

Industrial enterprises were badly hurt by the civil war. Many went out of business, and those that survived had to deal with the destruction of physical capital and the loss of workers and skills. Growth in the industrial sectors will be critical for increasing employment opportunities and living standards, particularly with scarce land and low productivity growth in agriculture. The sector shares weaknesses with the industrial sectors of many other African countries: low human capital and technology, high production and transportation costs, inefficient bureaucratic procedures, and limited financial services. In Rwanda the effects of genocide compound these problems, hampering the development of a strong entrepreneurial class.

Some efforts have been made to deal with these shortcomings, with a new private sector federation, an investment promotion agency to streamline investment procedures, and promotion of vocational education. The Poverty Reduction Strategy sets out a financial sector reform plan and an overhaul of the commercial legal environment to support the private sector. But initiatives to develop the nonagricultural sectors remain limited relative to the enormous and diverse challenges in strengthening the economy.

Medium-term outlook—some slowdown in growth

GDP growth will continue to be driven by agriculture and by high public expenditures, supported with donor funding. The rapid growth in 2002 was the result of very favourable weather. Some slowdown is expected, to around 6.5% in 2003 and 2004, with outcomes sensitive to weather. With Rwanda's high aid dependence, greater volatility of external inflows would be damaging. Monetary policy will remain centred on price stability, though inflation is likely to drift slightly upwards to around 4% in 2003—a result of VAT increases and exchange rate depreciation. The main influence on the external balances will be the international prices of Rwanda's main exports: tea and coffee. With inventories at record highs, the downward trend in coffee prices is expected to continue over the coming years, keeping the trade and current account balances in deficit. The requirements of poverty reduction and reconstruction will continue to put upwards pressure on the fiscal deficit, likely to be above 10% of GDP in 2003.

Failures in governance reforms could hurt the broader process of reconciliation in which they are embedded. If the institutions through which reconciliation is being managed lose credibility, this will affect the integrity of the 2003 elections, which in turn could affect prospects for future political stability and economic growth. Other problems stem from the demobilization of troops and the likely release of thousands of genocide suspects (see box 3.5). Judicious political management of these connected processes will therefore be critical, and the emerging institutional framework must be seen to include all ethnic groups.

> *"Donors need to be forgiving of reasonable deviations from orthodox stabilization policy"*

Unexpected costs arising from reconciliation, elections, and demobilization could upset attempts to build a well-functioning and accountable economic bureaucracy if initiatives such as the medium-term expenditure framework are derailed. Here, the fast pace of decentralization poses risks for more efficient budgetary processes, particularly with the limited institutional capacities at the local levels. This key element of reform must thus be carried forward with an eye to these critical constraints: too rapid an implementation could disrupt moves towards better economic management.

To the extent that the events of 1994 were conditioned by poverty and resource scarcity, diagnosis and possible solutions in the economic sphere will have to occur in tandem with social reconstruction and reconciliation. Given the dominance of agriculture in GDP and total employment, solutions to its problems will be vital. Essential prerequisites for its strengthening are technical progress and higher levels of commercialization. Given the land scarcity and soil degradation, economic diversification and the development of nonagricultural wage-labour opportunities will have to be propelled. Progress on this demanding set of tasks will increase living standards.

Rwanda's post-conflict situation must be taken into account, particularly in the conduct of fiscal policy. The crucial requirements of reconciliation, political normalization, and economic development may keep the fiscal deficit fairly high over the medium term. If sound expenditure implementation can be achieved, this will be justifiable. Given Rwanda's special context, donors need to be forgiving of reasonable deviations from the precepts of orthodox macroeconomic stabilization policy.

Moderate progress in the areas identified is likely to bring clear economic and social benefits. But the Poverty Reduction Strategy's aim of cutting poverty to half the 1990 level by 2015 will require average annual GDP growth of 7–8%. Given the structural weaknesses and the interlocking political and economic risks, poverty reduction of such magnitude is unlikely.

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