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The changing face of Rwanda's public debt

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List of acronyms

Abbreviation	Explanation
AfDB	African Development Bank
BNR	National Bank of Rwanda
BSHG	Budget Support Harmonization Group
CMA	Capital Market Authority
CSD	Central Securities Depository
CSR	Caisse Sociale du Rwanda
DAC	Development Assistance Committee of the OECD
DeMPA	Debt Management Performance Assessment
DMU	Debt Management Unit
DSA	Debt Sustainability Assessment
EAC	East African Community
GBS	General budget support
HIPC	Heavily Indebted Poor Country
IDA	International Development Association
IMF	International Monetary Fund
KCC	Kigali Convention Centre
MDRI	Multilateral Debt Relief Initiative
MIC	Middle-income country
MINECOFIN	Ministry of Finance and Economic Planning
MTDS	Medium-Term Debt Strategy
NSSF	Ugandan National Security Fund
ODA	Official Development Assistance
PFM	Public Financial Management
PforR	Program for Results
PIP	Public Investment Programme
PRSF	Poverty Reduction Support Facility
PTA Bank	Eastern and Southern African Trade and Development Bank
PV	Present value
RSE	Rwandan Stock Exchange
RSSB	Rwandan Social Security Board
RWF	Rwandan Franc
SACCO	Community savings and credit cooperative
SBS	Sector budget support
SCF	Stand-by Credit Facility

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Abstract

In 2005-2006 Rwanda benefitted from massive external debt cancellation by the international community under the enhanced Heavily Indebted Poor Countries (HIPC) and Multilateral Debt Relief Initiative (MDRI). As a result, the country's public debt sustainability was effectively restored and the Rwandan government was given a clean slate, on which a new, hopefully more successful debt policy could be written. This paper reviews how Rwandan public debt has evolved in the aftermath of debt relief and which priorities were put forward in the debt policy of the Rwandan government. We pay particular attention to public debt instruments which are new or of growing importance in the Rwandan context, i.e., non-traditional donor loans, the 2013 Eurobond, and longer-term local currency bonds. We also shed light on the implications of the post-relief debt accumulation for Rwandan debt management and for future debt sustainability. Finally, we consider the interaction between traditional donor finance and public debt in Rwandan by looking into the impact of the donor aid suspension of 2012 on public debt composition and on various fiscal and macroeconomic indicators. We conclude that, overall, Rwanda has been prudent in re-accumulating debt and in diversifying its sources of public finance, although the transition to a well-balanced equilibrium debt portfolio has not been without problems. The 2012 aid suspension, for example, had important implications for the development of the domestic debt market, next to broader fiscal and macroeconomic ramifications.

JEL Classification: H63, F34, F35, O10

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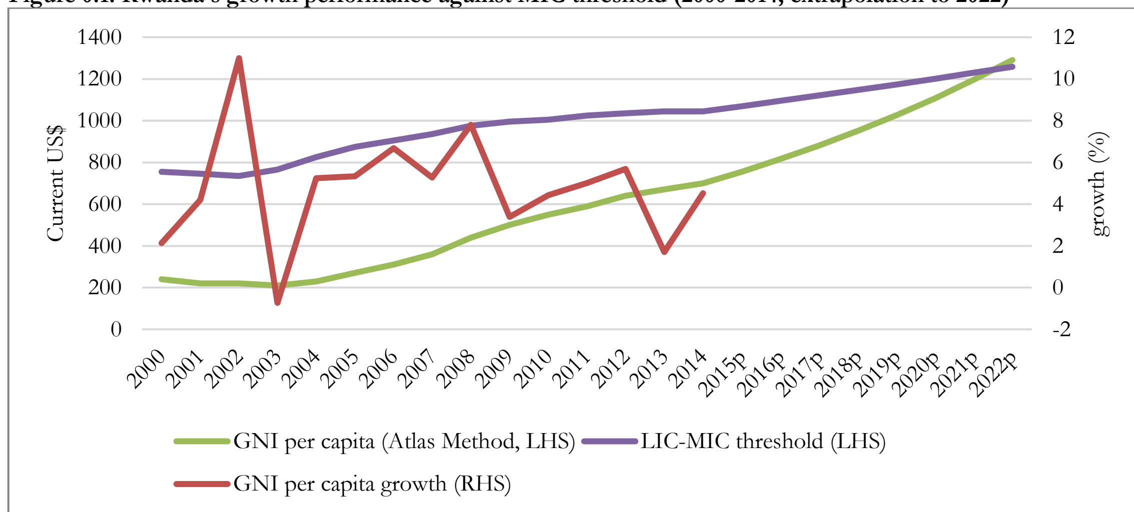
0 | Introduction

In 2005 and 2006 Rwanda was granted extensive debt relief under the Heavily Indebted Poor Countries (HIPC) and Multilateral Debt Relief (MDRI) initiatives, like many other African countries around that time. These international interventions effectively restored Rwanda's debt sustainability and provided the country with a 'clean slate' on which it could write a new, hopefully more successful debt story (Cassimon and Verbeke, 2014; Cassimon *et al.*, 2015). Whereas keeping public debt sustainable is already a daunting task in itself, the Rwandan government moreover aspires to fulfil large infrastructure needs and has put forward the target of reaching middle-income country (MIC) status by 2020 in its 'Vision 2020' programme (Republic of Rwanda, 2000). Since the launch of Vision 2020 by President Paul Kagame in 2000, Rwandan growth has averaged nearly 8% annually. If this trend continues, the country could indeed cross the World Bank's MIC threshold by 2022, as indicated in Figure 0.1.

Figure 0.1: Rwanda's growth performance against MIC threshold (2000-2014, extrapolation to 2022)



Note: we assume that, from 2015 onwards, Rwandan GNI per capita and the LIC-MIC threshold grow at the same rates as they did on average over 2000-2014.
Source: World Development Indicators and World Bank Country Classifications.

The realization of such goals has required the mobilization of additional resources at home and, especially, from abroad. Yet, at the same time, the country, long time a 'donor darling' (Marysse *et al.*, 2007), aims to reduce its reliance on traditional foreign aid over the medium term. This has led and will increasingly lead it to look elsewhere for funds. The International Monetary Fund (IMF) has aptly summarized the main challenges Rwanda faces in reconciling its various ambitions:

> *Rwanda continues to face the challenge of sustaining high growth in a context of uncertain donor flows, while avoiding the build-up of imbalances. Efforts to mobilize domestic revenue need to be reinvigorated, while judiciously using the limited borrowing space to finance priority projects and maintain debt sustainability* (IMF, 2015, p.1).

In this paper we study in great detail how Rwanda has used the opportunities presented by debt relief to diversify its public debt portfolio and the implications of post-relief debt accumulation for Rwandan debt management and future sustainability. In addition, we consider interactions between traditional donor finance and public debt by means of a case study of the donor aid suspension of 2012.

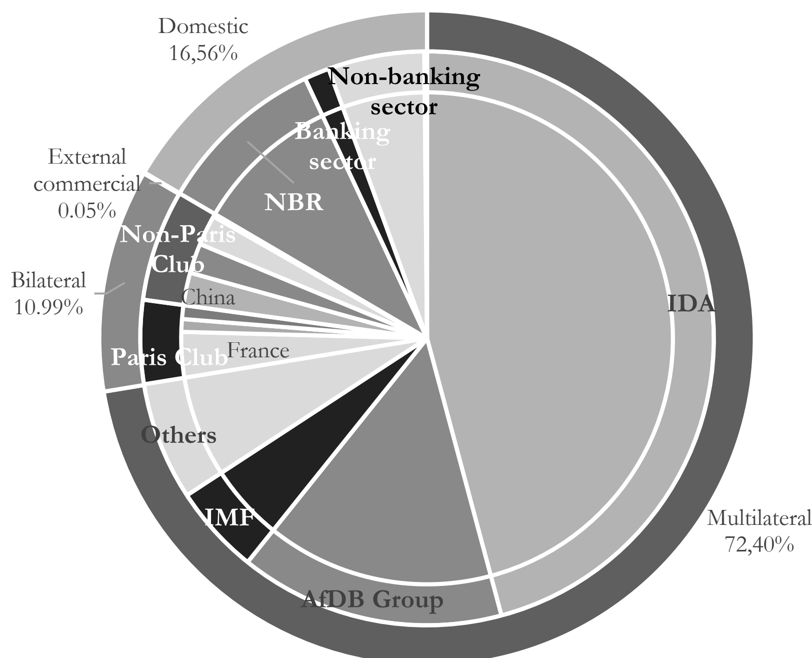
The remainder of the paper is structured as follows. In section 1 we briefly illustrate how HIPC and MDRI restored public debt sustainability in Rwanda. Section 2 reflects on some of the alternative public financing options for a country that aims to reduce its reliance on concessional donor loans and grants. Section 3 details the evolution of the Rwandan debt built-up after relief. We first zoom in on the composition of *external* public debt, which still constitutes the lion's share of Rwandan public debt. We thereby distinguish between multilateral, bilateral, commercial and publicly guaranteed debt. In a second subsection we look into *domestic* public debt, local currency bonds in particular, both from a national and regional, East African Community (EAC) perspective. Section 4 looks at the impact of the donor aid suspension of 2012 on public debt composition and on various fiscal and macroeconomic indicators. We also reflect on the longer-term effects of the aid suspension on Rwanda's relations with its traditional donors. Section 5 and 6 discuss the challenges Rwanda's changing debt portfolio poses to debt management and debt sustainability in the foreseeable future, thereby highlighting a number of risks and vulnerabilities. Section 7 concludes.

1 | HIPC and MDRI debt relief to Rwanda: A clean slate

The HIPC initiative was launched in 1996 by the international community in the wake of a proposal made by the G7. Previous attempts by bilateral and commercial creditors to solve the debt problems of many low-income countries had proven insufficient. By the mid-1990s it had become clear that creditors, including multilateral institutions, needed to deliver much more comprehensive and concerted debt cancellation to overcome the insolvency of their debtors. In 1999, following a thorough review of the initiative, the HIPC initiative was enhanced to further increase the size of debt relief and strengthen the link with poverty reduction (see Cassimon and Essers, 2013; Cassimon and Verbeke, 2014 and Cassimon *et al.*, 2015 and references therein). Also Rwanda was considered eligible for the Enhanced HIPC initiative in December 2000. Indeed, Rwanda fulfilled all the necessary criteria: the country was only eligible for the concessional facilities of the IMF and the World Bank (respectively the Poverty Reduction and Growth Facility and the International Development Association (IDA)); it had a satisfactory track record of macroeconomic and structural reforms, despite the post-conflict situation; and, most importantly, even after taking into account traditional debt relief mechanisms, Rwanda faced an unsustainable public debt burden (IMF, 2000).

Figure 1.1 shows the composition of Rwandan public debt in December 1999, on the eve of the HIPC initiative, when total Rwandan debt was about US$1.5 billion. External debt amounted to more than US$1.2 billion, or almost 84% of the total debt stock, and consisted of multilateral and bilateral debt. External debt owed to commercial creditors (such as international banks) was negligible. The main multilateral creditors were the World Bank's IDA and the African Development Bank (AfDB) Group, while major bilateral donors were France, China, Saudi Arabia and Kuwait. Domestic debt accounted for the remaining 16% of Rwandan public debt and was mainly composed of consolidated debt owed to the National Bank of Rwanda (BNR) and Treasury bills held by the banking and non-banking sector (IMF, 2000, 2005a; National Bank of Rwanda, 2004; see also Section 3.2).

Figure 1.1: Composition of Rwandan public debt (end-December 1999; % of total)



Source: IMF (2000) and National Bank of Rwanda (2004).

HIPC debt relief only targeted the external share of Rwanda's public debt stock. External public debt was defined as 'sustainable' by the IMF and the World Bank if its present value (PV) equalled 150% or less of the annual export of goods and services. Table 1.1 provides an overview of the calculations that were made to determine the relief needed to bring down Rwandan public debt to sustainable levels. It shows how the eligible, nominal external debt stock in 1999 is taken as a starting point and how the full application of traditional debt relief mechanisms already committed prior to HIPC, mainly by Paris Club bilateral creditors, is accounted for. To correct for differences in the concessionality of different claims, the PV of the debt stock (after traditional relief) is calculated. This adjusted 1999 debt stock is then compared to the level of debt which corresponds to the targeted 150% of Rwandan exports (averaged over three years, 1997-1999). The difference of US$451.2 million constitutes the debt relief in PV terms that was required from Rwanda's creditors to reach the sustainability target under the HIPC initiative. Debt sustainability would be attained if every creditor reduced its debt by 71.2% (again in PV terms).

Table 1.1: Calculation of debt relief provided to Rwanda under HIPC (end-1999; US$ millions)

	Total	Of which			
		Multilateral	Bilateral		Commercial
			Paris Club	Non-Paris Club	
Nominal external debt stock before arrears clearance and Paris Club debt relief (end-1999)	**1,259.7**	1,093	71.2	94.7	0.8
PV of eligible debt stock, taking into account traditional debt relief (end-1999)	**635.3**	557.4	44.6	33.0	0.3
3-year average of exports	**122.7**				
PV of debt-to-exports target (150% of exports)	**184.1**				
HIPC assistance needed to reach decision point target = PV of eligible nominal debt - PV of target	**451.2***	396.5	34.8	21.1	0.1
Common reduction factor	**71.2%**				

*Note that the HIPC assistance needed to reach the target (of US$451.2 million) and the sum of assistance needed per donor category do not add up. While the overall assistance needed was recalculated at completion point, taking into consideration new export data, the required debt relief per creditor category was not revised due to the minimal size of changes.
Source: IMF (2000; 2005a).

In March 2005 the Boards of the IMF and the World Bank agreed that Rwanda had maintained macroeconomic stability and had made sufficient progress in the implementation of the conditions ('triggers') agreed at decision point in 2000 to reach HIPC completion point. The policies put forward in the country's Poverty Reduction Strategy Paper had been followed in a satisfactory way, public spending on priority sectors had nearly doubled and key reforms in social sectors had been implemented. All triggers were met, with the exception of one focusing on the reform of the Rwandan tea sector (as the government did not receive any acceptable bid for the sale of a tea factory) (IMF, 2005a).

However, a recalculation of the debt-to-export ratio at completion point showed that projections at decision point had been too optimistic, i.e., the provision of debt relief agreed at decision point would be insufficient to restore debt sustainability. The main reasons behind this worse-than-expected debt ratio were lower export prices and exchange rate depreciation, factors which were considered by the Boards of the IMF and World Bank to be out of Rwanda's direct control. Even after incorporating beyond-HIPC debt relief granted by most Paris Club donors, a topping-up of US$243.1 million in PV terms was deemed necessary to attain the debt-to-export threshold of 150%. This topping-up consisted of additional bilateral relief provided by non-Paris Club donors and, primarily, of additional debt relief provided by multilateral donors, including on debt that was contracted after the 1999 cut-off date. As a result, debt relief provided by the different creditor categories amounted to much more than the 71% reduction agreed at decision point. In nominal terms, HIPC assistance reduced Rwandan debt by US$1.4 billion (IMF, 2005b). In July 2005 G8 leaders pledged to cancel the remaining debt of HIPC countries owed to the IMF, IDA and AfDB under the MDRI. Rwanda qualified for this initiative in January 2006, resulting in an additional US$516 million of nominal debt cancellation (Cassimon and Verbeke, 2014).

Since multilateral and Paris Club creditors were the driving forces behind the HIPC initiative, nearly 95% of Rwandan external debt relief was quasi-automatically assured. Most multilateral creditors

provided their debt relief by reducing the annual debt service falling due (e.g., debt service to the World Bank's IDA between 2001 and 2020 and to the AfDB until 2025). Paris Club creditors provided so-called 'interim' debt service relief between HIPC decision and completion point and cancelled the full debt stocks at completion point. To achieve HIPC targets, however, also non-Paris Club and commercial creditors, who were less directly involved in the HIPC agreement, were expected to provide comparable debt relief.[1] Between decision and completion point some of these non-Paris Club bilateral creditors did indeed provide (part of) the required debt relief. China cancelled some loans in 2001, representing US$14.2 million in PV, close to what traditional Paris Club terms of debt relief prescribed (IMF, 2005a). An agreement with the Kuwait Fund resulted in a rescheduling of US$28 million of debt in 2003, including US$20 million in arrears (National Bank of Rwanda, 2004; IMF, 2003). US$16.5 million owed to the Saudi Fund was rescheduled in 2001 (National Bank of Rwanda, 2005). Following HIPC completion point, China indicated its willingness to cancel all remaining debt owed by Rwanda, whereas Kuwait and Saudi Arabia only "noted the possibility of future debt relief" (IMF, 2006; 2007, p.50; National Bank of Rwanda, 2007). China eventually cancelled all of its outstanding claims, totalling about US$32 million (IMF, 2008a). Finally, the small amount of commercial creditor external debt was taken over and cancelled by one (unnamed) Paris Club creditor (IMF, 2005a; National Bank of Rwanda, 2004).

1 Rwanda's non-Paris Club creditors consisted of China, Kuwait, Libya, Saudi Arabia and the United Arab Emirates. China, Kuwait and Saudi Arabia together accounted for more than 97% of Rwanda's non-Paris Club debt stock.

2 | Reflections on debt diversification

Traditionally, developing countries' external finance has been provided by official bilateral and multilateral donors in the form of grants and highly concessional loans. As shown before, bilateral and multilateral credits constituted the largest share of Rwanda's public debt stock before HIPC debt relief. As developing countries grow richer their access to and demand for these resources (gradually) diminishes. In all but the poorest, most debt-ridden countries, donors may prefer to disburse concessional loans rather than grants, which, for any given aid envelope, implies that larger transfers to recipients can be made (as credits are eventually repaid) and which imposes some budget discipline on recipients. However, even loan-disbursing donors will not be able and/or willing to keep up with the increasing financing needs of fast-growing developing countries. On the recipient side, developing countries themselves may become increasingly wary of giving donors a say in their domestic consumption and investment decisions, as they attempt to set out their own development paths. Aid grants and loans are also notoriously volatile and unpredictable, complicating development planning by the recipient and undermining its effectiveness (see, e.g., Bulir and Hamann, 2008; Celasun and Walliser, 2008). Hence, developing countries expect and are expected to look for alternative public financing options. Table 2.1 lists some of the main advantages and disadvantages of grants and concessional loans versus two alternatives: commercial creditor external public debt and domestic public debt.[2]

2 There is of course a larger menu of domestic and external financing options, including increased tax mobilization and public-private partnerships. A discussion of these other alternatives goes beyond the scope of the current paper.

Table 2.1: A comparison of alternative public financing options for low-income developing countries

	Grants and highly concessional loans	**External commercial creditor debt (e.g., syndicated bank loans, international bonds)**	**Domestic public debt**
Foreign exchange at inflow	Yes	Yes	No
Exchange rate risk	Yes (for loans)	Yes	No
Net foreign exchange effect	Yes (for loans), ultimately net foreign exchange generation depends on projects financed	Yes, ultimately net foreign exchange generation depends on projects financed	No
Interest rate	(Very) low	Medium	Typically higher
Maturity	(Very) long	Medium	Typically shorter
Refinancing/ redemption risks		Large (bullet) principal repayment (for international bonds); interest rate variation at maturity	Short duration; interest rate variation at maturity
Conditionalities	(Often) donor conditionalities	No donor conditionalities but market discipline	No donor conditionalities but (some) market discipline
Other features	Volatile and unpredictable	Benchmark for private sector external borrowing Time- and money-consuming undertaking Difficult debt workout? (for international bonds)	Positive spill-overs for financial market development, and monetary policy Possible crowding out of credit to the private sector

Source: Authors' own elaboration.

Since commercial creditor external public debt, for example a syndicated international bank loan or international bond, is denominated in foreign currency (typically US dollar or euro) it provides the means to directly finance imports or to boost foreign exchange reserves at the time the debt is contracted, much like grants or concessional donor loans. However, external debt also exposes the country to exchange rate risk. A depreciation or devaluation of the country's own currency increases the cost of foreign currency debt (in local currency units). Domestic, local currency-denominated public debt holds no exchange rate risks for the debtor but, conversely, does not bring in much-needed foreign exchange.

Whereas interest rates charged on international bank loans or bonds are higher and maturities shorter than those of concessional loans, nominal repayment terms are typically more advantageous than in the case of local currency-denominated domestic public debt. This is mostly due to lower inflation and exchange rate risks (from the viewpoint of investors), greater legal certainty, higher liquidity and fewer capital controls in external, developed country financial markets (see Ito and Chinn, 2007). However, large currency depreciations have the potential to wipe out the benefits of

lower interest rates on commercial external debt (te Velde, 2014). Also, the relatively low interest rates on developing country international bonds, until recently, have been due (in part) to 'push' factors whose influence may diminish in the years to come (Sy, 2015; Gevorkyan and Kvangraven, 2016). In recent times, lower commodity prices and prospects of US policy rate hikes have been driving up developing countries' international bond yields, not the least for Sub-Saharan African sovereigns (some of which also suffer from deteriorating fundamentals) (see Standard & Poor's, 2015; Masetti, 2015). Commercial external debt thus increases countries' vulnerability to external trends and shocks. Whereas newcomers may decide to postpone their first external debt issuance in case of adverse market conditions, past issuers seeking to refinance their external debt when it becomes due will have to do so at the prevailing (possibly much increased) interest rates (Sy, 2015). Such refinancing risks are particularly important for debts with a 'bullet' repayment structure, such as most international bonds, which requires full principal repayment at a single point in time. Obviously, short-term (higher interest-rate) domestic public debt entails refinancing risks too.

One important advantage over donor loans and grants of both commercial external and domestic public debt is the absence of conditionality, i.e., greater freedom for borrowers over the use of funds, with the possibility of directing money to projects in which (traditional) donors are less eager to invest (te Velde, 2014). However, external commercial creditors are expected to subject debtor governments to market discipline (Merotto *et al.*, 2015) and to take into account broader portfolio considerations, which may only partly depend on country fundamentals. Access to longer-term domestic debt markets, at reasonable costs, requires a strong and credible institutional framework and sound macroeconomic management (Burger and Warnock, 2006; Claessens *et al.*, 2007; Mu *et al.*, 2013; Essers *et al.*, 2016). The extra macroeconomic discipline imposed by foreign and domestic investors can be a positive force, of course.

Marketable external and domestic public debt instruments may also have additional positive spill-overs. International sovereign bonds provide a pricing benchmark for companies that seek access to international financial markets (Mecagni *et al.*, 2014). Domestic government bonds provide a similar benchmark in local markets, fulfil the role of 'safe asset' in the economy, and can be used in open-market transactions by monetary authorities. As a result, a well-developed domestic bond market helps to support the mobilization and intermediation of domestic savings, boost financial development more generally, and improve monetary policy transmission (World Bank and IMF, 2001; Kumhof and Tanner, 2005; Abbas and Christensen, 2010; IMF *et al.*, 2013). Specific disadvantages to these marketable debt instruments include the costly and time-consuming process of preparing an international bond, especially for first-time issuance[3]; the possible crowding out of credit to the private sector by domestic government bonds (which compete for domestic savings); and the difficulty of debt workouts with a diffuse creditor base, which are likely to be much harder to coordinate than those that involve bilateral, multilateral or syndicated bank loans (Cassimon *et al.*, 2015).

Ultimately, the 'optimal' public debt structure or mix is one that balances the just-described advantages and disadvantages of donor loans, commercial creditor external debt, domestic public debt and takes into consideration other financing options that exist. It depends on the relative importance public authorities and other actors attach to each of these (dis)advantages, on the characteristics of the debtor economy and on the current and anticipated macroeconomic climate. According to the IMF's latest guidelines for public debt management the main objective should be

3 International bond issuance is typically preceded by the prospective issuer obtaining a credit rating from one or more rating agencies, selecting financial and legal advisers, preparing of all kinds of documentation, and participating in several international roadshows to gauge investor demand (see Das *et al.*, 2009).

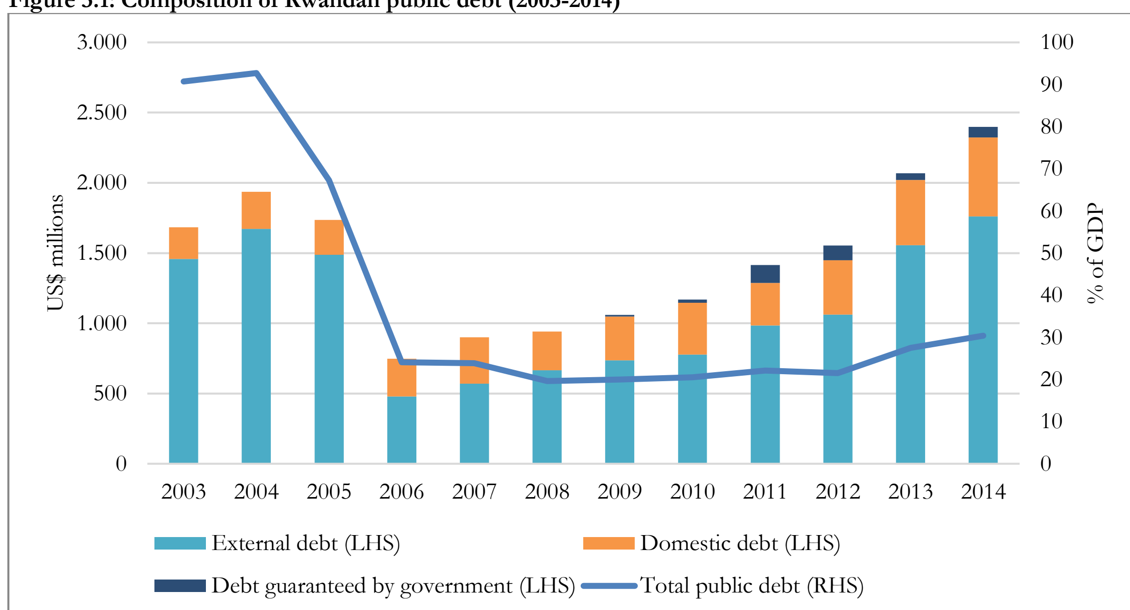
"to ensure that government's financing needs and payment obligations are met at the lowest possible cost over the medium to long run, consistent with a prudent degree of risk" (IMF, 2014a, p.7). This objective also forms the foundation of Rwanda's Medium-Term Debt Strategy (MTDS). Moreover, the Rwandan MTDS explicitly refers to the goal of developing an active domestic debt market and the desire to reduce the country's high dependence on concessional loans. In the following section we will look at the distance Rwanda has travelled so far, i.e., how the different components of Rwanda's public debt have evolved since debt relief.

3 | Debt build-up after relief

As a result of the different debt relief initiatives described in Section 1, Rwanda had a very low, sustainable debt stock by the end of 2006. To finance the country's ambitious development goals, and in view of its limited tax base and finite supply of donor grants, the Rwandan government needed to borrow again. Indeed, the purpose of HIPC and MDRI was not to keep debt ratios forever at their post-relief lows, but rather to provide new borrowing space, which should be filled responsibly (Merotto *et al.*, 2015).

Figure 3.1 indicates that, in nominal terms, total Rwandan public debt more than tripled between 2006 and 2014, from less than US$750 million to nearly US$2.4 billion in 2014. As a percentage of GDP, the rise in public debt has been much more muted, though, thanks to rapid economic growth: from 24% of GDP in 2006 to 30% in 2014. So while nominal public debt nowadays exceeds pre-relief levels, it amounts to only a third of what it used to be in relative terms. Rwanda also compares well to the rest of Sub-Saharan Africa, where public debt averaged 42% of GDP in 2013 (World Bank, 2015a). Unlike a number of other African countries, including Ghana and Mozambique, it has so far avoided a new explosive build-up of debt (Battaile *et al.*, 2015; Merotto *et al.*, 2015; UNCTAD, 2016).

Figure 3.1: Composition of Rwandan public debt (2003-2014)



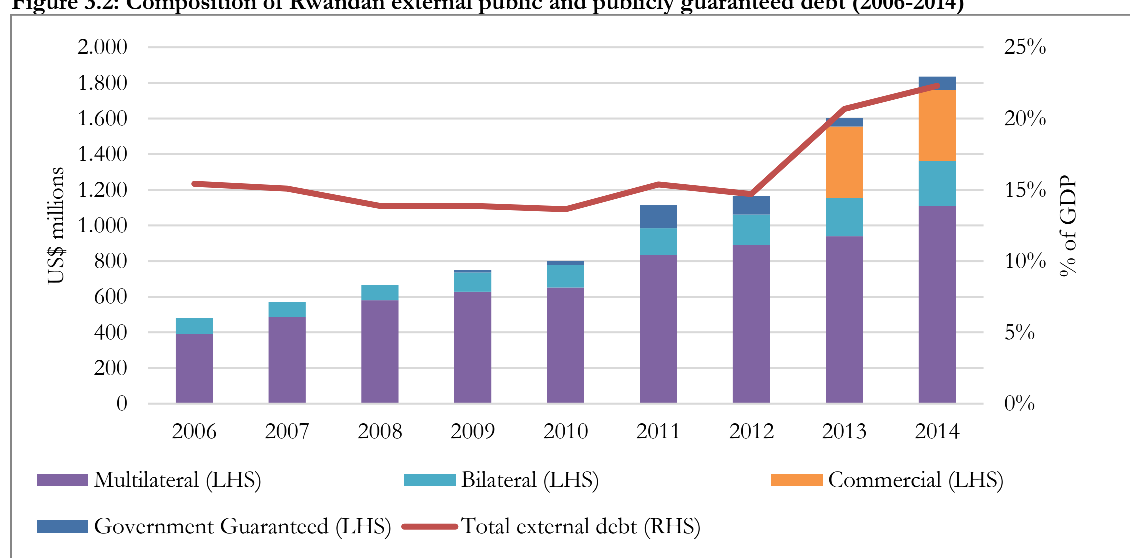
Notes: Domestic public debt is defined as debt denominated in local currency; in the Rwandan context this corresponds almost exactly with debt issued on domestic markets or debt owed to Rwandan residents (two alternative definitions; see Panizza, 2008).
Source: National Bank of Rwanda, MINECOFIN.

As not all sub-categories of Rwandan public debt have increased equally over time, debt composition has changed. Since HIPC debt relief only targeted external public debt, the domestic share of public debt initially jumped from about 16% prior to HIPC to 36% in 2006. But as external debt has since grown at a faster rate, domestic debt represented just under a quarter of the total in 2014. Debt guaranteed by the government makes up a much smaller share of public debt, reaching a maximum of 9% in 2011, but decreasing again to 3% by 2014. In the next sub-sections we will discuss, in turn, external and domestic public debt.

3.1 Evolution of external public debt

Small domestic savings and the lack of well-developed domestic debt markets have historically pushed developing countries towards external funding, both in the form of grants and loans. In Rwanda, even after debt relief, external debt still constituted the largest part of public debt. In 2006 the stock amounted to US$479 million or 15.4% of GDP. This increased to US$1.8 billion or 22.3% of GDP in 2014. Until 2008 Rwanda's external public debt consisted exclusively of (very concessional) loans from official bilateral and multilateral creditors (cf. Figure 3.2). From 2009 onwards, the Rwandan government also provided public guarantees. In 2013 Rwanda also contracted new debt from external commercial creditors, by issuing its maiden international bond. In the following subsections we zoom in, consecutively, on the post-relief evolution of Rwanda's multilateral, bilateral, commercial and publicly guaranteed external debt. We finish this section with a description of the external debt service.

Figure 3.2: Composition of Rwandan external public and publicly guaranteed debt (2006-2014)



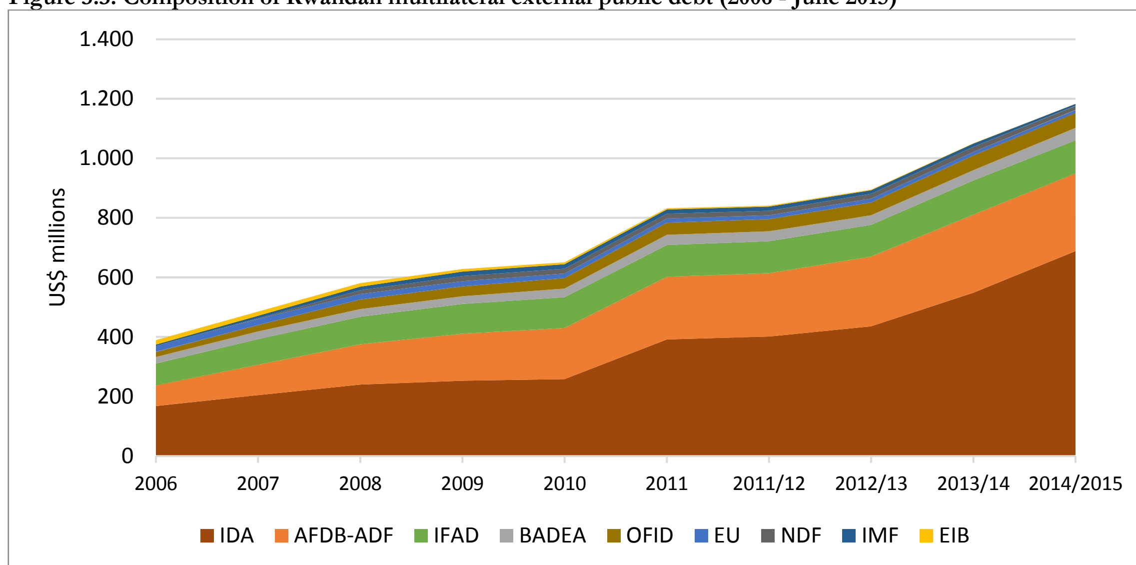
Source: National Bank of Rwanda, MINECOFIN.

3.1.1 Multilateral public debt

Multilateral debt remains the single largest component of Rwandan public debt. As shown in Figure 3.3, between 2006 and end June 2015 multilateral debt more than tripled, from US$390 million to US$1.2 billion. Compared to pre-relief stocks, the composition of multilateral debt has hardly changed. The two multilateral development banks still dominate. IDA had outstanding claims of US$688 million on Rwanda at the end of June 2015 or nearly 60% of total multilateral debt.[4] The main focal areas of the latest World Bank country strategy for Rwanda are the agricultural sector, rural feeder roads, energy, public sector governance and social protection (World Bank, 2014a). The AfDB comes in second; it was owed US$262 million at the end of June 2015 or 22% of multilateral debt. Projects in the latest AfDB country strategy focus on infrastructure (including transport, energy, ICT and in agriculture) and enterprise and institutional development (targeted to small and medium-sized enterprises). The International Fund for Agricultural Development (IFAD) is the third biggest multilateral creditor, good for US$111 million end June 2015. Their projects are all related to rural development.

4 Debts owed to IDA have further increased to US$893 million as of March 2016.

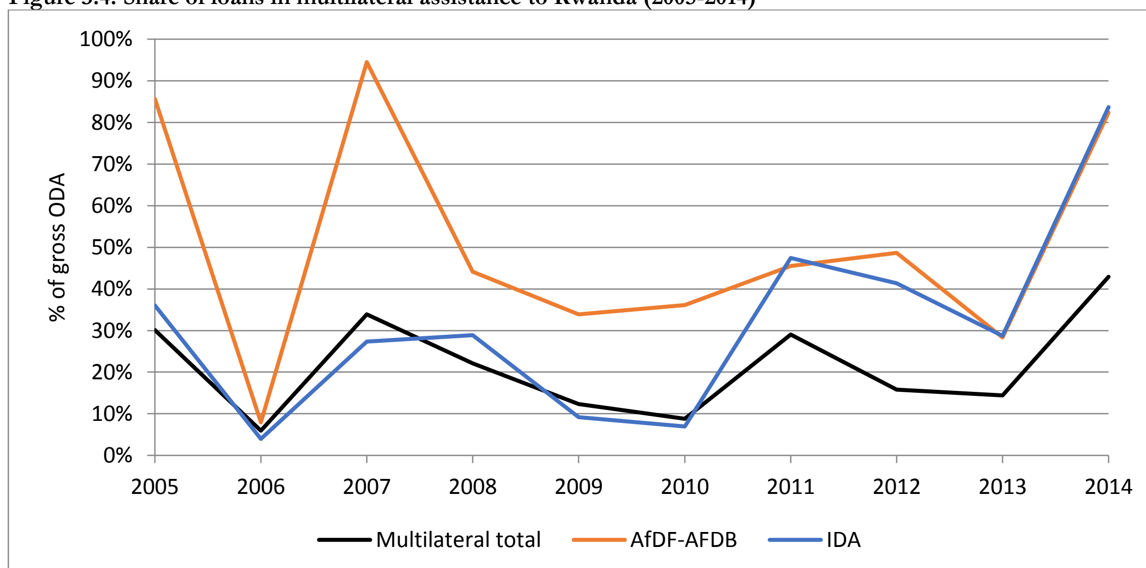
Figure 3.3: Composition of Rwandan multilateral external public debt (2006 - June 2015)



Notes: In order to align with the budget calendar of the East African Community (EAC), Rwanda switched from using calendar years to July-June fiscal years. BADEA is the Arab Bank for Economic Development in Africa; OFID is the OPEC Fund for International Development; EU is the European Union; NDF is the Nordic Development Fund; and EIB is the European Investment Bank.
Source: National Bank of Rwanda, MINECOFIN.

While the increase in multilateral debt mainly relates to the initiation of new projects, there is since 2014 an additional factor that contributes to this trend. As the country's classification of debt sustainability by the IMF and the World Bank was upgraded to 'low risk of debt distress' in 2013 (see Section 6), donor support from certain multilaterals has started to shift from grants towards concessional loans. Indeed, as Figure 3.4 shows, the share of loans in multilateral official development assistance (ODA) to Rwanda increased from around 20% between 2006 and 2013 to nearly 45% in 2014. IDA and AfDB are the main multilaterals that have this shift (see e.g., IMF, 2015; IMF, 2016a); the EU is still mainly providing grants. Since Rwanda aims to maintain its low risk status in the future, one can expect this trend to continue and more multilaterals replacing grants for loans. Moreover, some bilateral donors may follow the same course.

Figure 3.4: Share of loans in multilateral assistance to Rwanda (2005-2014)



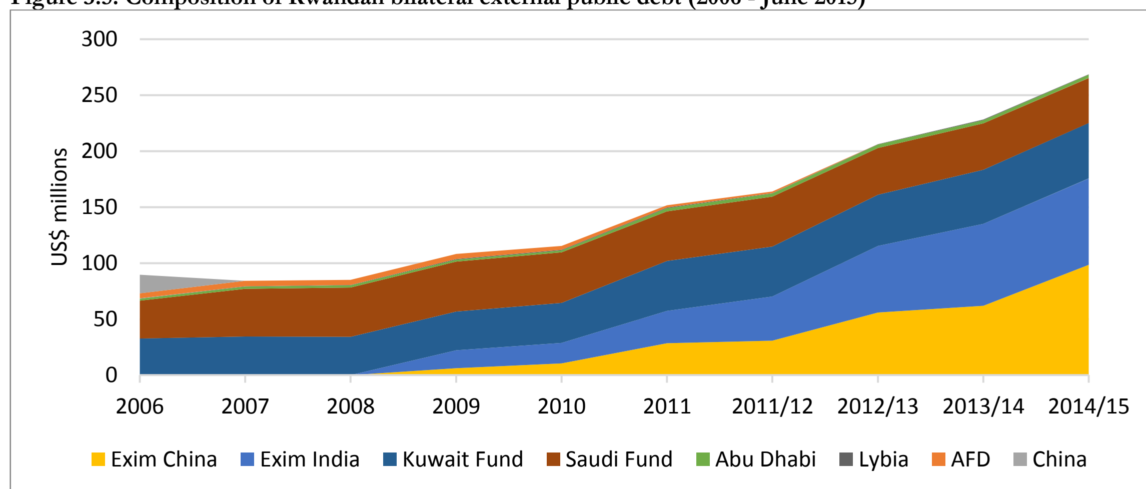
Source: DAC Aid Statistics.

3.1.2 Bilateral public debt

Bilateral external public debt also tripled in nominal terms between 2006 and 2015, from US$89 million to US$269 million (cf. Figure 3.5). In relative terms it hovered around 10% of total public debt, or 3% of GDP. Unlike multilateral debt, the creditor composition of bilateral debt has changed significantly since debt relief. Whereas before the HIPC initiative, Paris Club creditors accounted for more than 40% of bilateral debt (see Figure 1.1), currently none of these creditors has outstanding claims on the Rwandan government anymore. As Figure 3.5 shows, today non-Paris Club creditors like the Chinese and Indian Export-Import (EXIM) Banks and the Kuwait and Saudi Funds dominate. Projects financed by these non-traditional creditors are generally situated in infrastructure and energy. Examples include the participation of EXIM China, the Saudi Fund and Kuwait Fund in the construction of the Kivu Belt road[5]; the rehabilitation of the Kigali road network by EXIM China[6], the construction of a hydropower project on the Nyabarongo river and irrigation facilities by EXIM India[7]; the Saudi Fund's contribution to Rwanda's multi-donor Electricity Access Rollout Program[8]; and the Kuwait Fund's participation in the rehabilitation of the Gitarama-Mukamira road project and the expansion of the Munini hospital in Nyaruguru District.[9] Generally these projects are co-financed by multilateral and traditional bilateral donors with grants or loans.

Although it is difficult to obtain detailed information on the exact repayment terms of non-Paris Club bilateral debt, grant elements of Indian and Chinese credits to Rwanda are deemed to be around 35%-40%, slightly below the 45% threshold which has recently been set by the Development Assistance Committee (DAC) of the OECD as the minimum for loans to least-developed and other low-income countries to be counted as ODA (OECD-DAC, 2014).[10] Loans from the Kuwait Fund have had grant elements above 55%.[11]

Figure 3.5: Composition of Rwandan bilateral external public debt (2006 - June 2015)



Notes: In order to align with the budget calendar of the EAC, Rwanda switched from using calendar years to July-June fiscal years. AFD is the *Agence Française de Développement*.
Source: National Bank of Rwanda, MINECOFIN.

5 See e.g., Strange *et al.*, 2015, MINECOFIN, 2015 and Kuwait Fund, 2015.
6 See Strange *et al.*, 2015.
7 See High Commission of India in Kampala, 2013 and MINECOFIN, 2013b.
8 See World Bank, 2013a.
9 See www.kuwait-fund.org, visited on 13 April 2016.
10 Interview MINECOFIN, Kigali, 16 March 2016. IMF (2009) provides an estimate of 40.7% for the EXIM China loan related to roadworks in Kigali. IMF (2008b) reports a grant element of 40% for the Nyabarongo project loan offered by EXIM India. Note however that the discount rates used by the IMF differ from those recently approved by the OECD-DAC.
11 See www.kuwait-fund.org, visited on 17 April 2016.

While DAC donors have until recently provided all of their aid to Rwanda in the form of grants, the Rwandan government itself now asks DAC donors, generally through their respective development finance institutions, to provide additional finance in the form of loans for large infrastructure projects.[12] Long-time proponents of loans within the DAC South Korea and Japan, which condition their loans on a low risk of debt distress, have already responded positively to these demands.[13] South Korea will provide a US$51 million loan for the University of Rwanda's infrastructure and Japan will lend US$18.4 million to improve the stability and efficiency of Rwanda's electricity supplies.[14] More recent proponents of loans within the DAC, such as Germany, France and the EU, are being consulted by the Rwandan authorities and could follow suit.[15]

3.1.3 Commercial external public debt

Ever since debt relief, the Rwandan government has entered into only one (sizeable) debt contract with external commercial creditors, although it has also guaranteed other international commercial loans contracted by state-owned companies (see Section 3.1.4). On 25 April 2013 Rwanda issued a 10-year 'Eurobond' of US$400 million in international markets.[16] The Eurobond bears a fixed coupon of 6.625% per annum, to be paid in two semi-annual instalments (in May and November), and requires a single bullet repayment of the principal in May 2023. It was rated 'B' by both Standard & Poor's and Fitch (below investment grade, but in line with Rwanda's overall country rating). Investment banks BNP Paribas and Citigroup jointly acted as the lead managers, organizing roadshows in Europe, Asia and the US and selling the Eurobonds' notes on to interested investors. The bond's size, below the US$500 million threshold, made it ineligible for global benchmark indices (like JP Morgan's EMBI Global) that have been shown to be important drivers of international asset allocation and capital flows (Raddatz *et al.*, 2014). Yet total orders received for the Rwandan Eurobond amounted to no less than US$3.5 billion (an oversubscription of almost 900%), primarily from UK- and US-based fund managers. And with a yield at issuance of 6.875%, Rwanda paid only a moderate premium over the Eurobond of, for example, resource-rich Zambia, which was trading at a yield of 5.7% at that time, according to figures from Thomson Reuters Datastream.[17]

The Rwandan Eurobond's fortunate timing, before Federal Reserve Chairman Ben Bernanke's infamous tapering speech, and the overwhelming investor attention earned it the title of 'African Deal of the Year 2013', awarded by leading international finance magazine Euromoney.[18] Whereas overall Sub-Saharan African Eurobonds' performance worsened significantly from late 2014 onwards (until about mid 2016), on the back of steep oil and other commodity price declines, large

12 This can be explained by the fact that, for any given ODA budget, loans imply larger transfers to the recipient country today than grants (since loans are evaluated at their grant equivalent according to the new ODA accounting rules). Also, the 2012 aid suspension (see Section 4) resulted in a reduction of budget support and Rwandan authorities have asked donors to consider instruments that are more predictable and reliable.

13 Interview MINECOFIN, Kigali, 16 March 2016.

14 For Korea, see MINAFFET (s.d.) and Tumwebaze (2014). For Japan, see Butera (2016).

15 Interview MINECOFIN, Kigali, 16 March 2016.

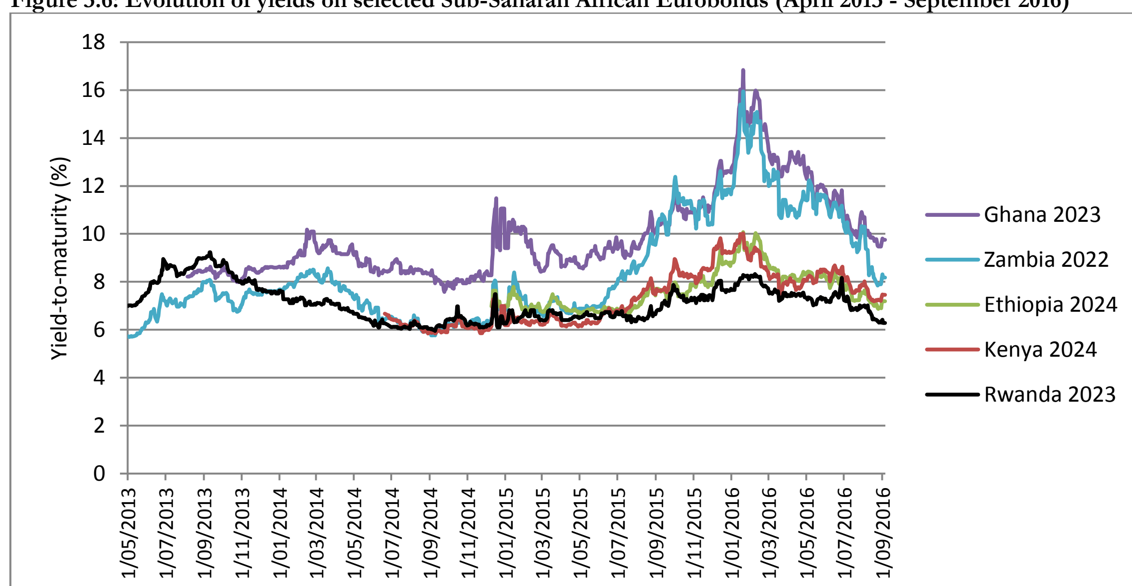
16 The term 'Eurobond' generally refers to an international bond denominated in a currency other than that of the issuer or of the place where it is issued. Like the majority of African Eurobonds Rwanda's is payable in US dollar. The Rwandan Eurobond is listed on the Irish Stock Exchange, governed by English law, and available as Regulation S notes outside the US and as Rule 144A notes to qualified US institutional investors.

17 The issuance yield was slightly above the coupon rate because the Eurobond was issued 'below par', at a price of 98.231 to 100 cents.

18 Rwanda had initially planned to issue its maiden Eurobond slightly earlier. After the 2012 budget support suspension by donors (see section 4) the Rwandan government waited a few months before going ahead with the issuance. Otherwise, investors might have thought that the Eurobond served merely to fill the budgetary gap left by donors, which would have resulted in higher interest costs (interview, MINECOFIN, Kigali, 16 March 2016).

currency depreciations and prospects of US interest rate hikes (Masetti, 2015; Standard & Poor's, 2015), the increase in Rwandan yields was relatively muted. Figure 3.6 plots the evolution of Eurobond yields-to-maturity for a selection of Sub-Saharan African sovereigns that issued such bonds around April 2013. One can observe that, after an initial surge to over 9% in September 2013, Rwandan Eurobond yields gradually fell to about 6% at the end of 2014 and seem to have somewhat diverged from those of other African sovereigns during the commodity price decline. As of early September 2016, the Rwandan Eurobond yielded about 6.28% annually (below its issue yield), compared to 9.75% and 8.18% on similar instruments issued by Ghana and Zambia. Also the Eurobonds of more economically diversified Kenya and Ethiopia yielded higher than Rwanda's.[19]

Figure 3.6: Evolution of yields on selected Sub-Saharan African Eurobonds (April 2013 - September 2016)



Notes: Years after country names refer to the year in which the respective Eurobonds mature. All Eurobonds are denominated in US dollar and had an original maturity of ten years. For more details on each of the individual Eurobonds, see Cassimon *et al.* (2015). Yields are those on Regulation S notes (trading outside the US).
Source: Thomson Reuters Datastream.

Besides the country's low risk of debt distress classification (see Section 6) and generally favourable macroeconomic fundamentals, the Rwandan Eurobond's appeal to investors has been explained by the government itself and by others as linked to clarity and vision about how the money would be used.[20] Indeed, the investor prospectus explains how Eurobond proceeds were to be spent primarily on infrastructure projects related to Rwanda's ambition of becoming an international business conference hub in the region. About US$120 million was used to repay outstanding balances on two earlier, less advantageous loans the government had contracted with Citibank and the Eastern and Southern African Trade and Development (PTA) Bank for the construction of the Kigali Convention Centre (KCC), and US$80 million to retire publicly guaranteed debt owed by the national airline RwandAir to the PTA Bank (used for fleet expansion). Another US$150 million was

19 As of February 2016, the difference between the yield spread of Rwanda's Eurobond above US Treasury bonds and the EMBI Global composite stripped spread stood at around 140 basis points. Standard & Poor's and Fitch upgraded Rwanda's (long-term foreign currency) sovereign credit rating to B+ in March 2015 and July 2014, respectively. In March 2016, Standard & Poor's revised its outlook for Rwanda's B+ rating from 'stable' to 'negative', citing downside risks to Rwanda's external position (see Section 6).

20 When asked about this, MINECOFIN staff argued that "investors liked the Rwandan story". Officials also stated that the main reason for not issuing a US$500 million or larger bond (in spite of market pressures to do so) was the lack of another US$100 million worth of sufficiently developed projects at the time (Interview MINECOFIN, Kigali, 16 March 2016). In 2012, when Eurobond plans were starting to take shape, an even smaller US$300 million was put forward by then Finance Minister John Rwangombwa (see Malingha Doya and Kay, 2012).

reserved for completing the construction of the KCC. The remaining US$50 million would be used to co-finance (with EXIM India; see Section 3.1.2) the ongoing 28 megawatt Nyabarongo hydropower project in the Southern province of the country. All this seems to stand in sharp contrast to Zambian and Ghanaian statements that their respective Eurobonds would be used to finance "capital expenditures" or for "general budgetary purposes".[21]

Nevertheless, there have been serious delays and other problems on the implementation and management side of the Eurobond projects, in particular the KCC.[22] Work on the KCC already started in 2009, when the Chinese firm Beijing Construction Engineering Group (BCEG) was awarded the contract for its construction. Initially, the centre, costed at US$226 million all-in, was to be completed by 2012, but adjustments to the (originally German) design and a lack of private sector co-financing (supposedly because many deemed the project to be overambitious) caused serious delays. Following further quarrels with BCEG about the slow progress of the KCC and the use of inferior materials, the Rwandan government in March 2015 hired a Swiss company, Axiome, to perform a full audit of the project. Apparently the final audit report was so damning that the whole BCEG team was sacked and replaced in June 2015 by Turkish construction firm Summa, which promised to finish the job by the first quarter of 2016. After this deadline was also missed, the KCC was eventually inaugurated in July 2016. The four-year delays inflated the KCC budget to an alleged US$400 million. Moreover, the postponement of the project implied a substantial 'cost of carry': since 2013 Rwanda has been paying significant interests on its Eurobond while part of the proceeds remained idle (supplementing the BNR's foreign exchange reserves).[23] Moreover, as long as the project was not finalized, it did not generate any foreign exchange to pay for Eurobond interests.

Meanwhile, the Rwandan government has contemplated issuing a second, larger Eurobond. At the Washington US-Africa Leaders summit in August 2014, President Kagame declared that Rwanda could issue up to US$1 billion in 2015 to erect a new international airport and to finance extra energy facilities (Richardson and Nichols, 2014). These plans were critiqued by opposition parties for overburdening Rwanda with too much unnecessary debt, for discouraging domestic resource mobilization, and with reference to the KCC delays.[24] With African Eurobond prices currently under pressure, a second Rwandan issuance has now been temporarily shelved. But once the external environment improves and a new set of strategic projects is ready for implementation, the country will likely return to international capital markets (IMF, 2016a). Since a second Eurobond would be used to finance additional projects *and* roll over (part of) the US$400 million bullet repayment on the first, due in 2023, bond size would have to be larger indeed.[25]

3.1.4 Publicly guaranteed external debt

A final category of Rwandan external debt is publicly guaranteed external debt, which arises from any explicit legal obligation of the government to service a debt in the event of non-payment by the

21 Quoted from the prospectuses of the Zambian 2022 and Ghanaian 2023 Eurobonds.

22 What follows is based on several accounts in the regional, international, and Rwandan press. See, among others, The East African, 28 March 2015, 25 April 2015, 8 August 2015 and 2 April 2016; Financial Times, 24 April 2015; New Times, 25 April 2009, 24 February 2011 and 3 February 2016. On delays in the completion of the Nyabarongo hydropower station, see, e.g., New Times, 31 August 2014.

23 The latest available IMF figures show that US$66.7 million of Rwandan Eurobond proceeds were still unused at end-June 2015 (IMF, 2016a).

24 See The East African, 17 August 2014.

25 Interview, MINECOFIN, Kigali, 16 March 2016. Alternatively, Rwanda could set aside a portion of its foreign exchange reserves each year to save for the 2023 bullet repayment of the Eurobond. No such 'sinking fund' arrangement is currently considered.

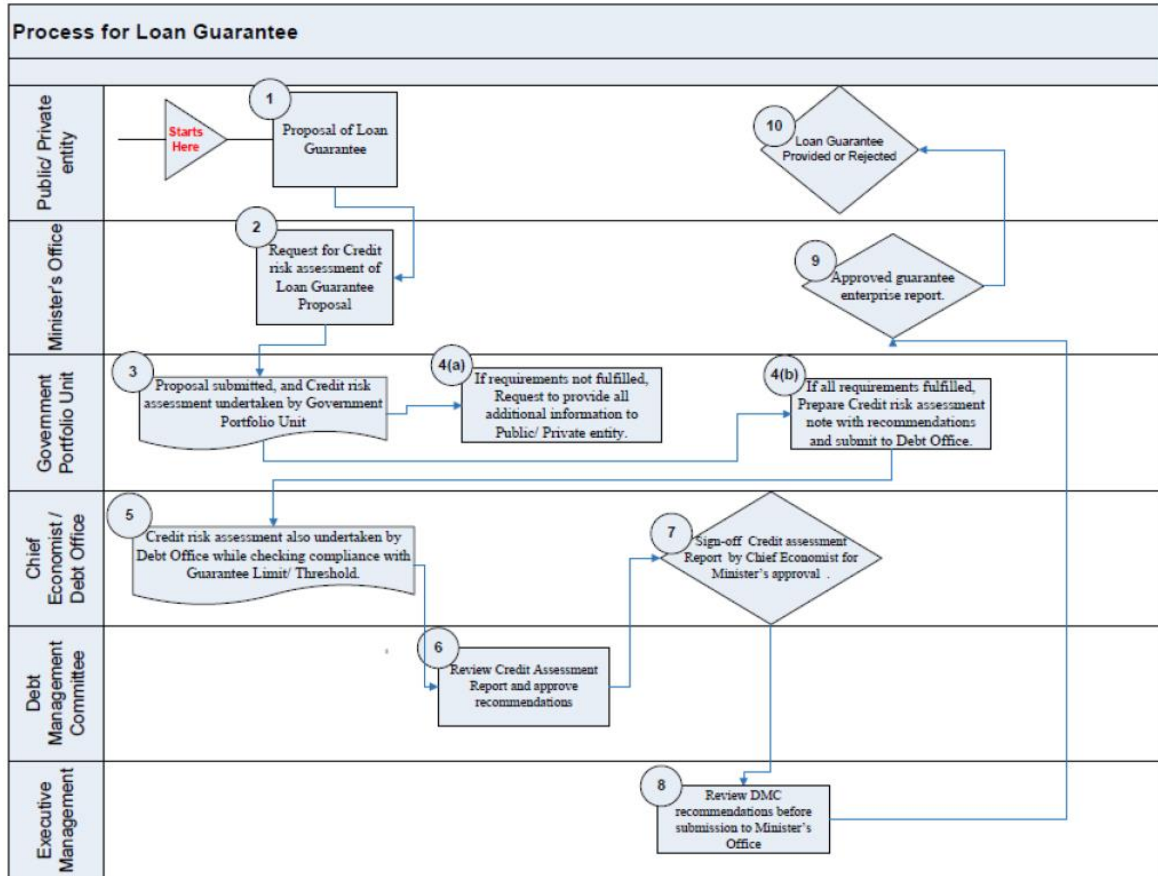
original borrower (IMF, 2016a). The Rwandan government extends guarantees in order to financially promote projects in specific sectors deemed of public interest (MINECOFIN, 2014). Nowadays, public guarantees are only provided on debt owed by RwandAir and the Rwanda Energy Group (IMF, 2015; Interview MINECOFIN, Kigali, 16 March 2016).

Publicly guaranteed debt was relatively important in 2011 and 2012, when it made up 9% and 7% of total debt, respectively. Its importance decreased in 2013 due to the repayment of outstanding claims on RwandAir by the PTA Bank with the proceeds from Rwanda's Eurobond (see Section 3.1.3). As such, part of publicly guaranteed debt became public debt. While the importance of guaranteed debt remained limited to 2-3% over the following years, it increased again in 2016 as the government plans to provide additional guarantees estimated at around US$250 million, or more than 10% of the total public debt stock at end-June 2014. These new guarantees cover commercial debt contracted by RwandAir for further expansion of its fleet and for the completion of the KCC (IMF, 2016a).[26]

To monitor more closely publicly guaranteed debt, the Rwandan Debt Management Unit (DMU) has recently formalized its process for the issuance of guarantees (MINECOFIN, 2014). Figure 3.7 shows the workflow to be followed when a public or private entity requests a loan guarantee from the government. Following a credit risk assessment by the Government Portfolio Unit and the DMU of the Ministry of Finance and Economic Planning (MINECOFIN), the Debt Management Committee, which also includes senior BNR staff, reviews the assessment and approves the recommendations. After approval by MINECOFIN's Chief Economist and a review by the Executive Management, the guarantee proposal is finally sent to the Minister of Finance to be signed (MINECOFIN, 2014).

26 The loan of RwandAir is provided by the PTA Bank and amounts to US$179 million. The loan for the KCC was still under negotiation at the moment of writing (email exchange MINECOFIN).

Figure 3.7: Workflow diagram for public loan guarantees

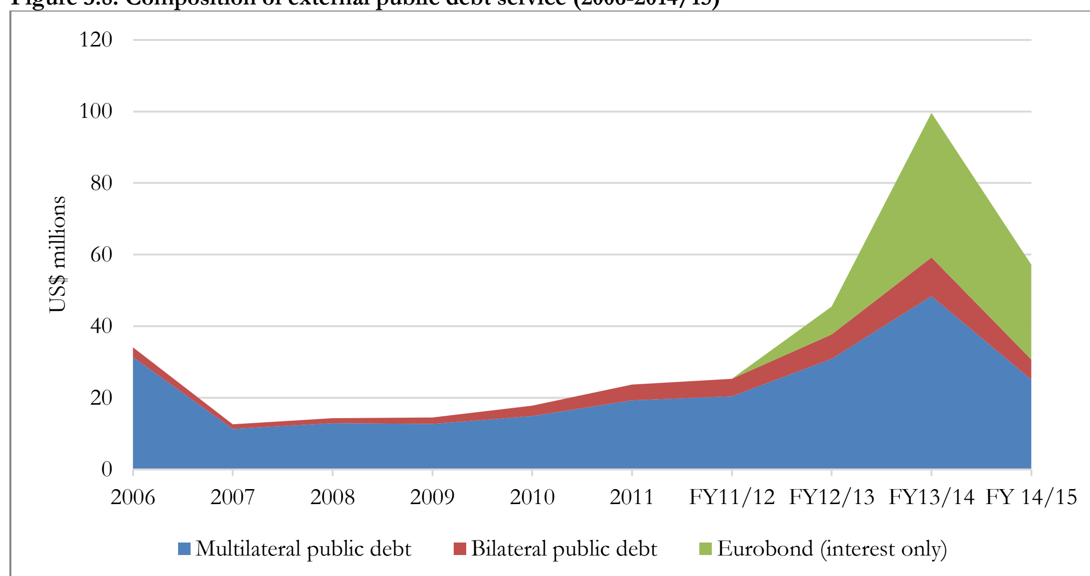


Source: MINECOFIN (2014).

3.1.5 External public debt service

Figure 3.8 shows the evolution of external Rwandan debt service on external public debt between 2006 and fiscal year 2014/15.

Figure 3.8: Composition of external public debt service (2006-2014/15)



Source: National Bank of Rwanda.

In line with the composition of the public debt stock, external debt service only consisted of payments on multilateral and bilateral debt until fiscal year 2011/12. Since 2012/13 debt service has more than doubled, mainly because of interest payments on the Eurobond issued in April 2013. The importance of bilateral debt service has been negligible over the whole period. Since 2006, bilateral debt service has never exceeded US$7 million, with the exception of 2013/14 (US$10.8 million). Given high concessionality and relatively low levels of bilateral debt, this part of debt service is not expected to increase significantly in the immediate future.

Multilateral debt service has been more important but is still limited compared to the multilateral share of the public debt stock, due to very low interests rates, the grace period included in newly contracted multilateral loans, and the delivery of HIPC assistance.[27] In the coming years multilateral debt service is however bound to rise. First, the grace period of multilateral loans contracted in the past nears its end. Second, debt service relief provided by IDA and AfDB will be finished by 2020 and 2025, respectively. Figure 3.9 shows how projected debt service to IDA, for example, increases from an average of US$13.6 million per year between 2017 and 2020 to US$37.8 million between 2021-2030. The estimated decrease in debt service after 2040 can be explained by the full repayment of past loans with maturities of 35 to 40 years. The contraction of new loans in the future is expected to undo this trend.

27 IDA loans to Rwanda, for example, carry an interest rate of 3.125% and have a grace period of six years during which no principal is to be repaid. Some multilateral donors have delivered their HIPC debt relief by means of debt service reduction (see Section 1). IDA and AfDB, for example, reduced debt service falling due on debt disbursed and outstanding as of end-1999 by 88.4% and 80% over the periods 2001-2020 and 2000-2025, respectively.

Figure 3.9: IDA estimated debt service payments (2017-2046)

Source: World Bank balances as of 30 June 2015. See http://www.worldbank.org/en/country/rwanda; visited on 18 April 2016.

Another factor which may potentially impact multilateral debt service is graduation from IDA. As Rwanda grows richer, it will first face less concessional terms on new IDA loans (i.e., shorter maturities, shorter grace periods and higher interest rates) and eventually lose access to IDA altogether.[28]

At US$26.5 million per year, interest payments on Rwanda's single Eurobond accounted for more than 46% of total external public debt service in fiscal year 2014/15. In case no new issuance would take place, annual commercial creditor external debt service will remain at US$26.5 million until 2022, spike in 2023 at US$400 million (due to the bullet principal repayment), and then return to zero afterwards. If meanwhile a second Eurobond is issued, its impact on debt service will depend on bond size and on prevailing investor appetite at the time of issuance.

28 As of April 2016, IDA-eligible countries whose GNI per capita remains above the operational IDA-only cut-off of US$1,215 for more than two consecutive years face so-called 'blend' terms on IDA loans: a maturity of 25 years, a grace period of 5 years and an interest rate of 3.3% for years 6-15 and 6.7% for years 16-25.

3.2 Evolution of domestic public debt

External public debt has received far more attention from policymakers and researchers than domestic debt, given its historical prominence in the overall public debt stocks of Rwanda and other former HIPCs. But as pointed out before, because of external debt relief, domestic debt has come to represent a non-negligible share of overall public debt. In nominal terms, Rwandan domestic public debt has grown from 147 billion Rwandan franc (RWF) (US$269 million) in 2006 to RWF391 billion (US$563 million) in 2014 (cf. Figure 3.1). As a percentage of GDP, domestic public debt first decreased from 8.6% in 2006 to 4.7% in 2011, before increasing again to 7.1% in 2014.

Rwandan domestic debt is made up of both 'marketable' and 'non-marketable' components. The non-marketable part of domestic debt includes first of all various legacy debts incurred by the government to the BNR, to local commercial banks, and to the former national social security fund, i.e., the *Caisse Sociale du Rwanda* (CSR).[29] Following agreements made in February 1996 between the BNR and the Rwandan government, unpaid pre-genocide government loans granted by the BNR and the March 1995 balance of the so-called 'revaluation account' (losses incurred by the BNR as a result of Rwanda's switch from a fixed exchange rate regime to a managed float in that year) were consolidated and charged with a uniform annual interest rate of 2%. Since 2002 the government has repaid the principal of this consolidated debt indirectly, by means of a 30% reduction in the annual dividend it receives as the BNR's sole shareholder (National Bank of Rwanda, 2015). Non-marketable domestic debt also comprises more recent overdrafts from the BNR, which are used to smooth the government's cash flow management. As per legislation dating from 2007, BNR advances to the government are limited to a maximum of 11% of gross ordinary revenues collected by the government in the preceding fiscal year. Interests on such advances are based on prevailing inter-bank money market rates and payable quarterly (National Bank of Rwanda, 2015).

Unlike the non-marketable part of domestic debt, which is now gradually being paid off, marketable domestic debt, i.e., Treasury bills and bonds, has been on the rise in recent years. This trend can be explained by the Rwandan government's deliberate efforts in building local capital markets, which, among other benefits, could reduce the country's dependence on external, foreign currency-denominated financing and facilitate domestic savings mobilization and intermediation (see Section 2 and references therein).[30] Indeed, different vintages of Rwanda's MTDS mention the objective of expanding and deepening the domestic bond market, above and beyond the usual cost-risk considerations that guide public debt management. The issuance of longer-term local-currency Treasury bonds has also been a structural benchmark in Rwanda's Policy Support Instrument arrangement with the IMF. According to BNR figures for September 2015, outstanding Treasury bonds and bills amounted to about 70-80% of total domestic public debt. The remainder of this section will therefore zoom in on these Rwandan franc-denominated marketable debt instruments.

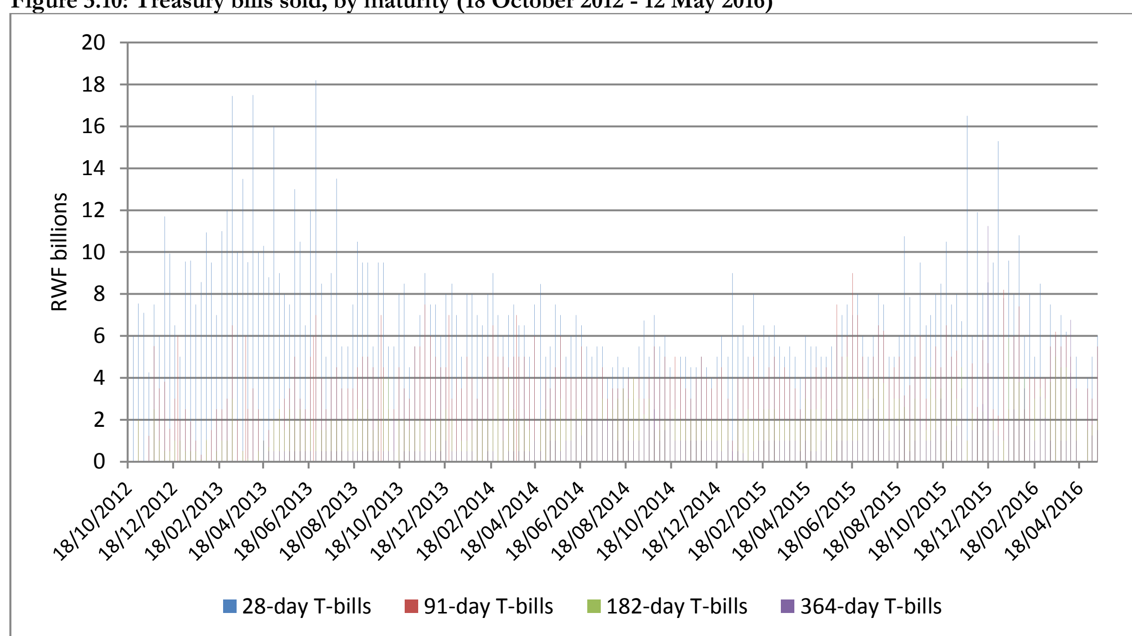
29 Arrears on contributions of different government institutions to the CSR were consolidated into a single government bond in 2006. As of February 2016, part of this bond was still outstanding on the books of the CSR's successor, the Rwandan Social Security Board (RSSB) (Interview, RSSB, Kigali, 17 March 2016). Non-marketable debt owed by the Rwandan government to local banks is linked to arrears accumulated by the government during the 1992-1993 war, especially on Treasury bills, and to more recent bank recapitalizations. After the genocide a new repayment schedule with local banks holding defaulted government debt was negotiated.

30 Interviews with senior staff of MINECOFIN, BNR, and the Capital Market Authority (15-17 March 2016) confirmed that Rwanda's objectives of local currency government bond market development go beyond simply financing the government budget (or longer-term infrastructure projects, more specifically). Interviewees referred to the role of local currency government bond markets in reducing donor dependency, in improving monetary policy transmission, in setting a benchmark for corporate bonds, and in nurturing a culture of longer-term saving (by offering companies and individuals a variety of fixed-income instruments to invest in).

3.2.1 Local currency bond market

Both Treasury bills and bonds are issued by the BNR, on behalf of MINECOFIN.[31] The BNR holds a weekly auction of Treasury bills with maturities of 28, 91, 182, or 364 days. These bills bear no conventional interest but are instead issued at a discount to their nominal redemption value ('below par'). Each Monday the BNR publishes on its website the planned amounts of Treasury bill issuance on Thursday; settlements with successful bidders take place on Friday. Figure 3.10 shows the amount of Rwandan Treasury bills sold by maturity since mid-October 2012.

Figure 3.10: Treasury bills sold, by maturity (18 October 2012 - 12 May 2016)



Source: National Bank of Rwanda.

Local currency Treasury bonds (instruments with maturities of more than one year) are issued since 2008. The first bonds had maturities of two and three years, followed by issuance of five-year bonds in 2010 and 2011. Only in February 2014, however, the government initiated a pre-announced quarterly bond issuance program, with larger volumes and longer maturities (up to 15 years at the moment of writing). All Rwandan Treasury bonds have fixed coupons that are paid to investors semi-annually. Coupon rates (and therefore bonds' issue yields) are not pre-set by the government or BNR but rather determined through a process of 'book-building'.[32] Through licensed banks or other capital market intermediaries, 'competitive' bidders, tendering RWF50 million or more, submit a form to the BNR with the amount(s) they would like to invest in a particular bond and the rate(s) at which they would like to do so (multiple, differently priced bids are allowed). Smaller, 'non-competitive' bidders can only declare their preferred amount, with a minimum of RWF100,000. Upon closure of the bidding, the bond is allotted to the different

31 Part of the Treasury bills issued by the BNR is for monetary (open market operation) purposes only. The proceeds of such bills are sterilized in deposits held as other BNR liabilities and the IMF excludes them from its definition of net domestic financing of the government (IMF, 2016a).

32 Some price guidance is given by the Rwandan government/BNR, however, through informal contacts with large bond investors before actual bond auctioning. Similar book-building methods as described here are used in auctions of Treasury bills. Any party that has opened a CSD account with the BNR may participate in Treasury bill or bond auctions. Unlike in Kenya, there is currently no primary dealer system in Rwanda in which designated dealers have particular privileges (like exclusive access to specific bond/bill segments) and obligations (like further distribution of and market-making in bonds/bills) (see Arnone and Iden, 2003). There have been discussions about introducing such primary dealers in Rwanda but, according to several of our interviewees, the idea has been abandoned for now.

investors until the offered, pre-announced amount is exhausted, starting with the non-competitive bids and serving the competitive bidders in ascending order of bid rates. In the end, the non-competitive and competitive investors whose bids are retained all face the same coupon rate/issue yield, which is calculated as the weighted average of the accepted competitive bid rates.[33]

Table 3.1 provides more details on the 19 Treasury bonds auctioned between January 2008 and October 2016, amounting to about RWF169 billion in total. It can be seen that, with the exception of the securities issued in February 2008 and April 2010, Rwandan Treasury bonds have been heavily oversubscribed, suggesting a large appetite of domestic investors for such safe assets. This should perhaps not come as a surprise. All of these bonds have yielded returns between 8% and 13.5% per annum, while inflation has generally remained below 6% in recent years.[34] Rwanda has so far resisted issuing Treasury bonds that exceeded the initially announced amounts, a practice which could increase uncertainty and invoke strategic bidding behaviour (see Abbas and Sobolev, 2009 on Tanzania).[35]

Table 3.1 further indicates that local commercial banks and, more recently, local non-bank institutional investors have been the main buyers of Rwandan Treasury bonds. As of February 2016, 11 commercial banks are licensed by the BNR, next to three microfinance banks, one development bank and a cooperative bank. With the notable exception of Bank of Kigali, Rwanda's largest commercial bank by assets (and until 2007 50% owned by *Belgolaise*, a subsidiary of Fortis), most 'local' banks are now part of regional or pan-African banking groups, as the result of a series of mergers and acquisitions which started in 2008.[36] The Rwandan non-bank institutional investor sector consists mainly of pension and (life and non-life) insurance funds.[37] Again as of February 2016, 54 pension funds and 14 insurance companies were active in Rwanda. Among these, the government-owned Rwandan Social Security Board (RSSB), created in 2010 after the merger of the CSR and the *Rwandaise d'Assurance Maladie*, is clearly dominant, both in terms of the size of assets under management and Treasury bond investment. From the RSSB's balance sheets it appears that the organization holds between 20% and 40% of each of the Treasury bonds issued since 2014 in its portfolio (thus accounting for much of the institutional investor shares listed in Table 3.2). Similar to other, private pension and insurance schemes, the RSSB seeks to match its long-term liabilities with long-term assets.[38] In addition, and unlike other domestic investors, the RSSB is exempted from the 5% withholding tax on bond interest earnings. The remainder of domestic investors exists of much smaller individual and other retail investors, like the approximately 500 community savings and credit cooperatives (*Umurenge* SACCOs) active in the country. Greater participation of retail investors, for which specific allotment shares are now reserved in bond auctions, explains why the total number of bids has significantly increased since the new quarterly bond issuance programme.[39]

33 Interview, BNR, Kigali, 15 March 2016.

34 For comparison, average bank lending rates (for much riskier individual or corporate projects) have hovered around 16-17% between 2008 and early 2016. See http://www.bnr.rw/index.php?id=329, visited on 30 March 2016. Yields are generally somewhat higher than coupon rates in Table 2 since most bonds have been issued slightly below par.

35 From time to time, however, the BNR has dipped into oversubscriptions during Treasury bill auctions.

36 Examples include I&M Bank Rwanda, KCB Rwanda and Equity Bank, the parent banks of which are headquartered in Kenya; Crane Bank Rwanda, part of a Ugandan group. Access Bank Rwanda and Guarantee Trust Bank Rwanda, which have Nigerian parents; and Ecobank Rwanda, part of a pan-African bank originating in West Africa and headquartered in Togo.

37 For more details on Rwanda's financial sector, see World Bank (2015c) and annual reports of the BNR.

38 As of February 2016, Rwandan Treasury bonds accounted for 13.2% of the RSSB's consolidated portfolio (which comprises the independently managed portfolios of its pension and occupational hazards scheme and its medical scheme). Other major asset classes in which the RSSB invests include bank term deposits (34%), local equity (24.9%) and real estate (16.8%).

39 For example, according to BNR press releases, of the 64 bids received for the November 2015 Treasury bond, no less than 47 originated from retail investors (39 individuals and eight SACCOs). In the May 2016 Treasury bond retail investors represented 48 out of 57 bids.

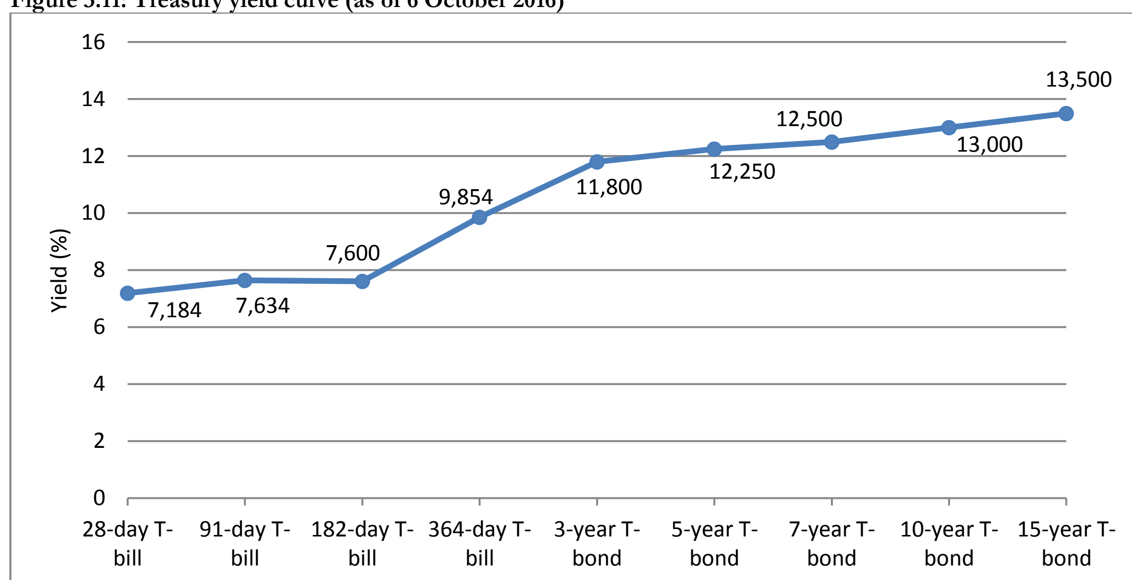
Table 3.1: Treasury bonds issued (January 2008 - October 2016)

Bond No.	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19
Maturity	2 years	2 years	3 years	2 years	2 years	2 years	5 years	3 years	5 years	3 years	5 years	7 years	3 years	10 years	5 years	3 years	5 years	15 years	5 years
Auction date	17-01-08	31-01-08	28-02-08	14-01-10	29-04-10	19-08-10	18-11-10	24-02-11	06-10-11	27-02-14	27-08-14	26-11-14	25-02-15	27-05-15	26-08-15	25-11-15	24-02-16	25-05-16	24-08-16
Maturity date	15-01-10	01-02-10	25-02-11	13-01-12	26-04-13	17-08-12	13-11-15	21-02-14	30-09-16	24-02-17	23-08-19	19-11-21	23-02-18	16-05-25	21-08-20	22-11-18	19-02-21	09-05-31	20-08-21
Amount offered (RWF millions)	5,000.00	5,000.00	5,000.00	2,500.00	2,500.00	2,500.00	3,500.00	2,500.00	2,500.00	12,500.00	15,000.00	15,000.00	15,000.00	10,000.00	15,000.00	15,000.00	15,000.00	10,000.00	15,000.00
Number of bids received	18	13	14	6	8	17	18	10	7	56	91	59	62	55	77	64	88	57	67
Amount of bids received (RWF millions)	7,550.00	4,257.00	7,227.00	3,500.00	1,500.00	6,700.00	7,050.00	8,200.10	9,000.00	17,420.10	34,755.60	19,807.10	15,937.20	22,818.70	23,449.90	26,458.60	33,917.80	21,560.60	20,785.90
Subscription (%)	151	85	145	140	60	268	201	328	360	139	232	132	106	228	156	176	226	216	139
Amount sold/allotted (RWF millions)	5,000.00	4,257.00	5,000.00	2,500.00	1,500.00	2,500.00	3,500.00	2,500.00	2,500.00	12,500.00	15,000.00	15,000.00	15,000.00	10,000.00	15,000.00	15,000.00	15,000.00	10,000.00	15,000.00
to local investors (%)	99	99	100	100	100	100	100	100	100	94	93	100	99	69	96	100	99	98	N/A
to foreign investors (%)	1	1	0	0	0	0	0	0	0	6	7	0	1	31	4	0	1	2	N/A
to commercial banks (%)	93	94	90	100	100	85	67	100	77	52	40	46	48	21	50	54	39	35	25
to non-bank institutional investors (%)	7	6	8	0	0	15	33	0	23	47	57	53	50	77	47	43	52	50	71
to retail investors (%)	0	0	2	0	0	0	0	0	0	1	3	1	2	2	3	4	10	15	4
Fixed coupon rate (%)	8.000	8.000	8.250	9.500	9.750	9.500	11.000	10.250	11.250	11.475	11.875	12.475	11.550	12.925	11.950	11.800	12.000	13.500	12.250
Yield at issuance (%)	8.026	8.244	8.460	9.177	10.544	9.456	11.121	10.425	11.150	11.625	12.000	12.500	11.700	13.000	11.950	11.800	12.000	13.500	12.250

Note: Percentages may not add up to 100% due to rounding.
Source: Capital Markets Authority, National Bank of Rwanda.

Although similar auction-level data could not be obtained for Treasury bills, the aggregate numbers suggest it is mostly local commercial banks that invest in this segment. With average annualized yields roughly between 3% and 8% over the past two years, Treasury bills offer banks an attractive and highly liquid vehicle to park funds temporarily, until a good (higher-yielding) investment project presents itself.[40] Indeed, when looking at Rwanda's current Treasury yield curve (Figure 3.11), the difference between Treasury bill and bond yields seems relatively limited.

Figure 3.11: Treasury yield curve (as of 6 October 2016)



Notes: Yields are most recent yields at issuance in primary market as of 6 October 2016. There are no recent yields available for two-year Treasury bonds; the last one was issued in August 2010.
Source: National Bank of Rwanda.

In 2011 the Rwandan government established both the Capital Market Authority (CMA) and the Rwandan Stock Exchange (RSE), replacing the earlier Capital Market Advisory Council, which oversaw over-the-counter trading of financial assets. The current CMA advises on government policy, develops the legal framework for Rwandan capital markets, issues various licences (e.g., for stock brokers or asset managers) and supervises the RSE, among other tasks. Whereas all recent Treasury bonds are listed on the RSE (next to bonds by I&M Bank and the World Bank's IFC and seven corporate equity listings), hardly any secondary market trading has taken place so far. According to data received from the RSE, total bond turnover on the exchange, including the two corporate bonds, amounted to a paltry RWF2 billion in 47 deals between January 2014 and February 2016.[41] This 'buy-and-hold' of Treasury bonds is likely due to a combination of factors: the lack of critical mass of bonds (and number of investors) in the primary market; the fact that retail investors, with typically a more actively managed asset portfolio, have been underrepresented (apart from in the February and May 2016 bonds); and the relative attractiveness of Treasury bonds vis-à-vis alternative investments in Rwanda. Also, investors may refrain from selling relatively high-yielding safe assets like Treasury bonds out of fear that other financial market participants and the broader public would interpret this as signalling liquidity or other balance sheet problems. The collective outcome is that no single investor is comfortable with being the first to put large amounts of bonds on sale.[42]

40 For some banks this may be preferable to locking away liquidity for a longer time in a Treasury bond, especially since there is almost no secondary market for such bonds (see further). (Interview, Head of Treasury of local commercial bank, Kigali, 14 March 2016).

41 This compares to a joint turnover of almost RWF83 billion and 2,387 deals in Bank of Kigali and Bralirwa (*Brasseries et Limonaderies du Rwanda*) shares over the same period, the two most actively traded stocks on the RSE. Treasury bills cannot be traded on the RSE.

42 Interview, Head of Treasury of local commercial bank, Kigali, 14 March 2016.

Through the CMA and other bodies the Rwandan government has taken several initiatives to further develop the local currency bond market and boost bond trading, which could lower domestic debt service costs, including attracting more retail investors by familiarizing people with the financial instruments available in Rwanda through the organization of education and trainings and by setting up the Rwanda National Investment Trust, which will manage a number of collective investment schemes aimed at lower-income clients.[43] Plans exist to increase the volume (and frequency) of different Treasury bond issues over the medium term. So far MINECOFIN has been very cautious in setting bond sizes to avoid crowding out credit to the private sector, which competes for the limited domestic savings in Rwanda. More precise forecasting of the available liquidity in the economy may clear the path towards larger bond issuance.[44]

3.2.2 Local currency bond market in a regional perspective

As a small economy it is natural for Rwanda to look to its East African Community (EAC) neighbours for further capital market development. Kenya, Tanzania and Uganda formed the modern-day EAC in 2000, with Rwanda and Burundi joining in 2007.[45] In 2013 these five EAC countries signed a protocol describing the prerequisites and convergence criteria for a monetary union. A single currency and common EAC central bank are expected to be phased in by 2023/2024. Regional integration of capital markets is considered to be an integral part of EAC aspirations. As a matter of fact, Articles 85 and 86 of the EAC Treaty urge member countries to harmonize the regulatory and legislative frameworks of their respective capital markets, to remove constraints to cross-border investment and trade of financial instruments, and to establish a regional stock exchange.[46]

There are different ways in which regional capital market integration may benefit a small economy like Rwanda (see Ferhani *et al.*, 2009; and Irving *et al.*, 2016 for Rwanda specifically). First of all, and most obviously, it can help to realize economies of scale, boosting trading volumes and the liquidity of financial assets. A larger and more active region-wide investor base will improve access to and reduce the cost of financing for bond issuers, including governments. To the extent that regionalization also results in a more diverse investor base, with heterogeneous time horizons and other preferences, (governments') access to finance may also become more stable. Besides, sharing market infrastructure and intermediaries can improve cost efficiency and stimulate knowledge transfers. Regional integration has the potential to increase the visibility of all the countries in the region to international investors, thus facilitating smaller economies' interaction with global markets.

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43 For more details on the initiatives taken and/or planned, we refer to the capital market policy actions in Rwanda's second Financial Sector Development Program (FSDP II, which covers 2013-2018) (see Andrews *et al.*, 2012, p. A18-A20) and the status update thereof contained in Schellhase *et al.* (2015). At the moment of writing, the CMA is making the final edits to a ten-year Capital Market Master Plan (CMMP) for Rwanda, which will formulate recommendations that apply to both the buy and sell side of capital markets (Interview, CMA, Kigali, 15 March 2016).

44 Interview, MINECOFIN, Kigali, 16 March 2016. The crowding out argument applies not only to Treasury bonds sold directly to private credit-providing commercial banks. It could well be that greater investments in Treasury bonds by the RSSB (partly) substitute for the term deposits this organization has placed in commercial banks, hence indirectly reducing the latter's ability/willingness to extend longer-term private sector loans. That said, the high levels of liquidity in the Rwandan banking system (exceeding regulatory requirements by a large margin; see World Bank, 2015c) seem to suggest that, in principle, there could be some room to invest more in Treasury bonds without necessarily reducing private sector credit (which may be limited for other reasons).

45 A former EAC arrangement between Kenya, Tanzania and Uganda was dissolved in 1977. South Sudan was admitted to the EAC in March 2016 and ratified the EAC Treaty in May 2016.

46 For the full text of the Treaty, see http://www.eac.int/resources/documents/eac-treaty, visited on 30 March 2016.

Beyond all this, there could be benefits on the investment side too. A larger pool of assets to invest in, like bonds issued by the different governments in the region, may help regional investors to better diversify portfolio risks and lower transaction costs, which would, *ceteris paribus*, enhance investment returns. This is not to say that regional capital market integration is an easy, risk-free undertaking (Ferhani *et al.*, 2009). For example, successful capital market regionalization hinges on an aggregated market of sufficient size and quality as well as a minimum of existing economic, financial and political linkages between countries in the region. At the same time, strengthening capital market links exposes countries to shocks originating in their neighbours or beyond. Furthermore, there needs to be political will to overcome vested interests (who could lose rents in case of regionalization) and 'national pride' (Irving *et al.*, 2016). And whereas, arguably, the smaller, less advanced capital markets in the region stand to gain most from regionalization in terms of increased scale and knowledge transfers, there is always the risk that market activity and liquidity migrate towards the larger, more developed capital markets.

Yabara (2012) explains that strategies for integrated (government) bond markets cover a wide spectrum, from a pure 'institution-based' approach to regionalization, whereby local markets are merged into one regional entity under unified supranational regulations and supervisors, to a 'non-institution-based' approach, where debt securities are cross-listed on local markets, barriers to cross-border investments removed and legislation, supervision and market infrastructure harmonized.[47] He goes on to argue that while EAC members have committed themselves to institutionalized integration under a monetary union, they would also benefit from pursuing non-institution-based regionalization in parallel; something they have been actively doing over the past few years. The EAC Common Market Scorecard, which tracks compliance with EAC protocols, shows that by 2014 Kenya had made it easiest for capital to move across EAC member states, followed by Rwanda and Uganda. Burundi and Tanzania had much more restrictions on capital movement in place (World Bank and EAC Secretariat, 2014).

Currently Rwanda does not directly restrict regional or other foreign investors from participating in its local currency Treasury bond market. Moreover, EAC residents can enjoy the same, reduced 5% withholding tax on interest earnings from Treasury bonds with maturities of three years and above as Rwandan nationals (rather than the 15% charged to non-EAC investors). On the other hand, the cost of opening a Central Securities Depository (CSD) account with the BNR is considered to be greater than that in Kenya or Uganda.[48] The Rwandan CMA often seeks inspiration from its Kenyan counterpart in drafting legislation and policy. Rwanda's capital market frameworks are said to be well-suited for further regional integration, in part because Rwanda was a latecomer in terms of capital market development (compared to Kenya, Uganda and Tanzania) and frameworks could be designed with regionalization in mind.[49] There has also been some (albeit slow) progress in linking up CSD systems and stock exchange trading platforms between Rwanda and the other EAC countries.[50] The Rwandan banking sector is already integrated in the EAC region, with several

47 Yabara (2012) mentions the West African Economic and Monetary Union (WAEMU) as an example of the institution-based approach to integrated debt markets and the Association of Southeast Asian Nations (ASEAN), which has implemented initiatives aimed at stimulating cross-border investment in bonds, as an example of non-institutionalized integration.

48 Interview, MINECOFIN, Kigali, 16 March 2016. Moreover, the World Bank and EAC Secretariat (2014, p.15) note that "[a]pplicants requesting licensing to participate in the Central Securities Depository may be refused if their domestic law does not offer reciprocal market access under the same conditions to participants governed by Rwandan Law".

49 Interview, CMA, Kigali, 15 March 2016.

50 For example, according to the New Times (5 April 2016), the RSE will very soon switch to an automated trading platform, after which it can be linked to the earlier automated platforms of the Nairobi Stock Exchange (NSE), the Uganda Securities Exchange (USE) and the Dar es Salaam Stock Exchange (DSE).

banks being subsidiaries of Kenyan- or Ugandan-based groups.[51] Also most of the intermediary companies providing brokerage and other stock market services at the RSE originate from countries in the region, which suggests knowledge transfer is already ongoing.[52] On the Rwandan investor side, the RSSB, for example, is allowed to allocate a maximum of 20% of its pension scheme investment portfolio to EAC fixed-income instruments. Finally, it appears that, on the whole, Rwandan authorities envision further EAC capital market integration to be a positive force, with more benefits than costs or risks for Rwanda. At first glance, there seems to be little resistance to (eventually) relinquishing the functions of institutions such as the CMA and RSE to the regional level.[53]

So far there has been very little EAC or other foreign participation in the Rwandan Treasury bond market in practice, however, as evident from Table 3.2. The only exception has been Rwanda's May 2015 ten-year Treasury bond, in which about 30% was allotted to foreign investors thanks to a RWF3 billion investment by the Ugandan National Social Security Fund (NSSF). In spite of Rwandan capital market harmonization efforts, regional investors may be put off by costly and risky currency conversions, by the limited supply and illiquidity of Rwandan Treasury bonds, and by the bond returns, which are relatively attractive for domestic investors but generally lower than in the other EAC member countries.[54] The (planned) adoption of a common currency could reduce transaction costs, but may have downsides too, given that exchange rates have helped absorb asymmetric shocks in the EAC (Drummond *et al.*, 2015). MINECOFIN has organized campaigns and roadshows to promote Rwandan Treasury bonds in the region. These have shown that there is indeed interest from EAC investors, especially from Kenyan and Ugandan institutional sectors, but that such investors may be served better by larger bonds with longer maturities (hence the NSSF's participation in Rwanda's first ten-year bond). Figure 3.12, which compares the assets under management of pension and insurance funds between the different EAC members, shows the immense potential of a regional investor base for Rwanda.

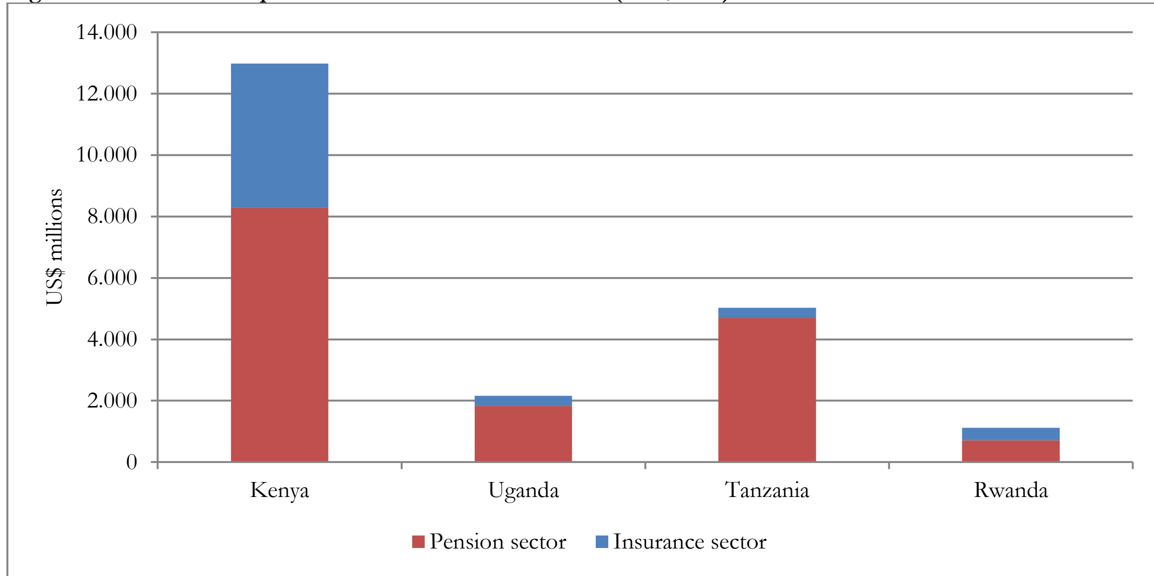
51 See footnote 36. Since February 2013, Bank of Kigali also operates an office in Kenya. There is also significant regional presence in the Rwandan insurance sector (World Bank, 2015c).

52 Examples include Faida Securities and SBG Securities (both from Kenya), MBEA Brokerage Services (Uganda) and Core Securities (Tanzania).

53 Interviews, CMA and RSE, Kigali, 14-15 March 2016.

54 Interviews, MINECOFIN and Head of Treasury of local commercial bank, Kigali, 14-16 March 2016.

Figure 3.12: Size of EAC pension and insurance fund assets (2014/2015)



Notes: Data as of June 2015 for Tanzania and Rwanda, and as of December 2014 for Kenya and Uganda. No up-to-date figures were available for Burundi.

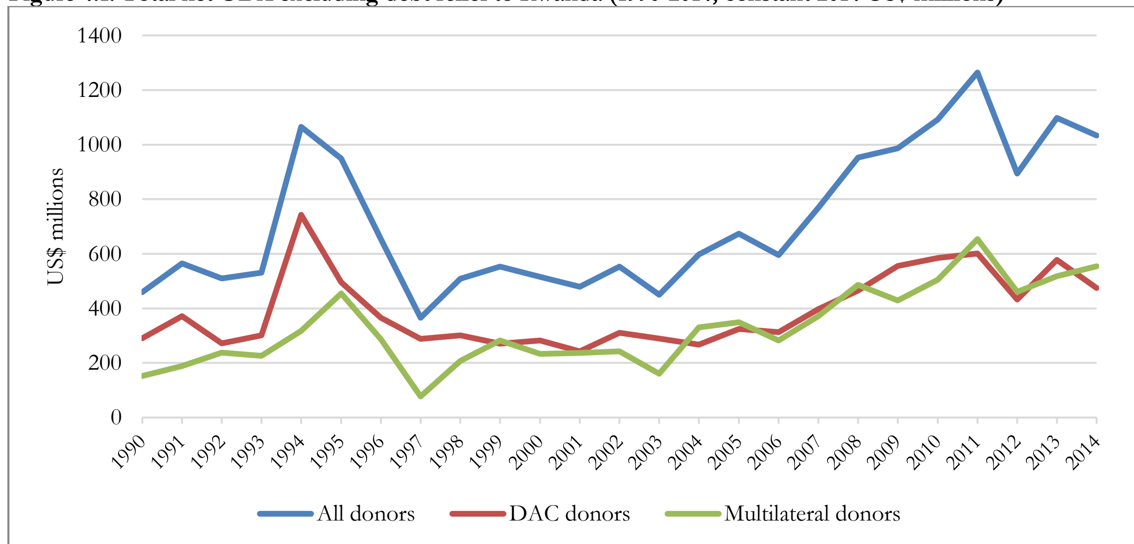
Source: Central Bank of Kenya, Bank of Uganda, Bank of Tanzania, National Bank of Rwanda.

4 | The 2012 aid suspension: Implications for public debt (and beyond)

While the debt diversification policy of the Rwandan government is a laudable (and perhaps necessary) strategy, the transition to a new equilibrium has not been and will not be, in the foreseeable future, without 'hiccups'. In this section we consider one such 'hiccup' by studying the interaction between traditional donor finance, debt diversification and macroeconomic and fiscal policy. We specifically look at the case of the aid suspension of 2012. We believe this episode illustrates well how divergences between ex ante expected and ex post realized donor financing drove the country to use short term fixes, which in their turn had important implications for the smooth transition to a new debt portfolio, besides broader macroeconomic and fiscal consequences. We also shed light on how the suspension changed the longer-term relationship between the government and its donor-creditors. That said, throughout the section we make abstraction of the political motivations that drove donor decisions.

Over the last two decades, Rwandan development has been heavily supported and financed by multilateral and DAC donors. The Rwandan success story of simultaneously realizing economic growth, poverty reduction and increased equity, referred to by Oxford Professor Paul Collier (2012) as the 'hat trick', has made donors eager to take up Rwanda in their aid envelope. Figure 4.1 shows how, following a short-lived upsurge in the wake of the 1994 genocide, net ODA (excluding debt relief) by donors reporting to the DAC steadily increased between 1997 and 2011 from just below US$400 million to more than US$1.2 billion (in constant dollar terms).

Figure 4.1: Total net ODA excluding debt relief to Rwanda (1990-2014, constant 2014 US$ millions)



Source: DAC Aid Statistics.

The upward trend in net ODA shows an abrupt end in 2012. Following the publication of a draft UN report end-June 2012, in which Rwanda was accused of supporting armed groups in the Eastern Democratic Republic of Congo, different donors suspended their aid to the Rwandan government in the second half of 2012 (Faust and Koch, 2014). Below we illustrate some of the reactions of different donors:

The **United States** was the first donor to suspend its aid to the Rwandan government. The US State Department suspended US$200,000 of support to the Rwandan Military Academy (Reuters, 2012; Wallis *et al.*, 2012).

The **Netherlands** were the first European country to suspend budget support to Rwanda following the publication of the draft UN report (Bossuyt *et al.*, 2014; Wallis *et al.*, 2012). EUR5 million sector budget support (SBS) for the justice sector, which was pledged for the fiscal year 2012/13 but which had not yet been signed, was suspended (House of Commons, 2012).

In the summer of 2012 **Germany** cancelled the planned signing of an agreement of EUR21 million in general budget support (GBS) for the fiscal years 2012/13, 2013/14 and 2014/15. This GBS was committed in November 2011 as part of a EUR60 million German-Rwandan development cooperation agreement (BMZ, 2012; personal communication German Development Cooperation). The money was fully reprogrammed towards three other programmes:

- EUR7 million for Technical and Vocational Education and Training (TVET), agreement signed 16 October 2013 (MINECOFIN, 2013a; personal communication German Development Cooperation)
- Two tranches of EUR7 million for the Local Administrative Entities Development Agency, agreements signed 20 June 2014 and 9 February 2015 (personal communication German Development Cooperation)

These programmes did no longer constitute budget support, but rather project-type interventions channelled through the public sector (according to the DAC Aid Statistics database).

The **United Kingdom** had planned two disbursements of GBS in 2012/13. The first disbursement of GBP16 million, originally planned for July 2012, was delayed after the publication of the UN draft report. Following consultations with the Rwandan authorities, half of the amount was eventually disbursed in September 2012. The remaining GBP8 million was reallocated to two programmes aimed at improving service delivery in the education (GBP5 million) and agriculture (GBP3 million) sectors. In November 2012 British Secretary of State for International Development Justine Greening decided that the second disbursement of GBP21 million would not be released because of a breach of the partnership principles agreed in the Memorandum of Understanding between the UK and Rwanda. The UK GBS was part of a three-year GBP111 million Growth and Poverty Reduction Grant (2012/13-2014/15) of which eventually only GBP8 million was effectively disbursed. Most of the non-disbursed GBS was reprogrammed to SBS through a government-owned social protection initiative directly focused on the poor, including cash transfers and cash-for-work schemes (House of Commons, 2012, 2013; DFID, 2012, 2013, 2014a; Roopanarine, 2013).

Sweden, which does not provide GBS, withheld SEK114 million (about EUR13 million) in project aid to Rwanda (House of Commons, 2012).

In September 2012, in coordination with its member states, the **EU** decided to disburse all funds for ongoing programmes as planned (EUR47 million). New decisions for additional budget support were however postponed. Following the Framework Agreement signed by 11 African countries[55] in February 2013 the EU started negotiations on the provision of SBS (Rutayisire, 2013; House of Commons, 2012; Feio, 2013).

55 The eleven signatories of the Agreement were Angola, Burundi, the Central African Republic, the Democratic Republic of Congo, the Republic of Congo, Rwanda, South Africa, South Sudan, Tanzania, Uganda and Zambia.

Poverty Reduction Support Facility (PRSF) 9 of the **World Bank** (US$125 million), the second part of an anticipated three-year PRSF series (8-10), was prepared and negotiated with the Rwandan authorities. Although the Development Policy Lending (DPL) for PRSF-9 was ready to be presented to the World Bank's Executive Board, the Rwandan country team did not bring it forward "for reasons not connected to the substance of the operations. Rather as assessment was made that donors (and Board stakeholders) views had changed at that time and they were refraining from general budget support" (World Bank, 2014b, p.21). Also the DPL for PRSF-10 was not presented to the Board. Feeling the pinch of the various donor suspensions, the Rwandan government in February 2013 requested the World Bank to provide emergency support to compensate for the shortfalls in aid (interview, World Bank, Kigali, 15 March 2016). The World Bank responded with an emergency package of about US$50 million disbursed in May 2013.Most of the earlier committed funds was eventually reprogrammed towards SBS and projects (World Bank, 2014b; interview, World Bank, Kigali, 15 March 2016).

On the Board of the **AfDB**, the Scandinavian countries and India forced a delay of the decision on the disbursement of US$38.9 million in budget support from July to September 2012. The Board decided to wait for the decision by the World Bank (Wallis *et al.*, 2012; House of Commons, 2012). Eventually, the AfDB did not suspend any aid to Rwanda in 2012/13. All committed GBS was however disbursed as SBS on demand of the Rwandan authorities themselves (personal communication AfDB).

Belgium suspended its military cooperation with the Rwandan government (Senaat, 2013b). For the fiscal year 2012/13 two tranches of SBS for the health (EUR9 million) and justice (EUR3 million) sectors were foreseen in the 2011-2014 Indicative Cooperation Program and therefore planned in the original Rwandan budget of 2012/13. However, as the underlying legally binding financing agreements were not yet signed, officially due to budgetary challenges in Belgium, the funds were not disbursed. The Minister of Foreign Affairs therefore did not consider this to be an aid suspension (Anciaux, 2012; House of Commons, 2012; Senaat, 2013a). From the perspective of Rwanda, however, it clearly resulted in an aid shortfall. The financial agreement was finally signed in June 2013 and funds were disbursed in October 2013.

4.1 Short-term consequences

The impact of the above-described donor suspensions is first of all visible in the Rwandan government's budget. As a result of the suspensions, only 40% of the expected budgetary grants were disbursed between July and December 2012, the first half of the Rwandan fiscal year (World Bank, 2013b). The full impact over the whole fiscal year 2012/13 is shown in Table 4.1, where three vintages of the budget are compared: (1) the original budget submitted to the Rwandan Parliament before the start of the fiscal year and the publication of the UN draft report; (2) the revised 2012/13 budget of December 2012, which takes into account initial donor reactions to the UN report, Rwandan government reactions and the Eurobond issuance; and (3) the executed budget. Grants actually disbursed to the Rwandan government amounted to RWF364.9 billion or 26% below the original budget, with nearly equal cuts in budgetary and capital (project) grants. On the financing side, budgetary loans were 7% below the originally budgeted amounts and non-Eurobond project loans even 35%, partly also reflecting delayed project implementation. Confronted with such aid delays/cuts, the government reacted in two ways: cutting expenditures and increasing revenues from other sources.[56]

On the expenditure side, there were cuts and/or payment delays in different categories in order to protect priority spending and limit the overall fiscal deficit. In the recurrent budget, wages were prioritized, but all new civil service recruitments were halted, including teachers and health personnel. As a result, spending on wages and salaries could be reduced by nearly 8%. Because of similar freezes on new recruitments and reduced allocation for goods and services in communication, training, repairs, consultancies, etc., 'transfers' even declined by more than 13%. The development budget was cut by 13% by means of postponing new projects and slowing down the execution of ongoing projects (IMF, 2013; MINECOFIN, 2013c; DFID, 2014a).

On the revenue and financing side, the Rwandan government focused mainly on a number of short-term, temporary solutions to compensate for cash-flow problems resulting from the aid suspensions, assuming that most aid would still be disbursed later in the fiscal year. The aid shortfall was partly offset by postponing the payment of invoices (with arrears accumulating to RWF34.4billion or 1.2% of GDP by end-December 2012); by issuing more Treasury Bills (see Figure 3.10 in Section 3); and by making use of the BNR overdraft facility. These interventions were mainly implemented in the first half of the fiscal year and could be partially scaled back as delayed donor disbursements accrued in the second half.

56 What follows is necessarily a partial analysis. Apart from the aid suspensions, there may be other reasons why the executed budget differs from the original budget proposal.

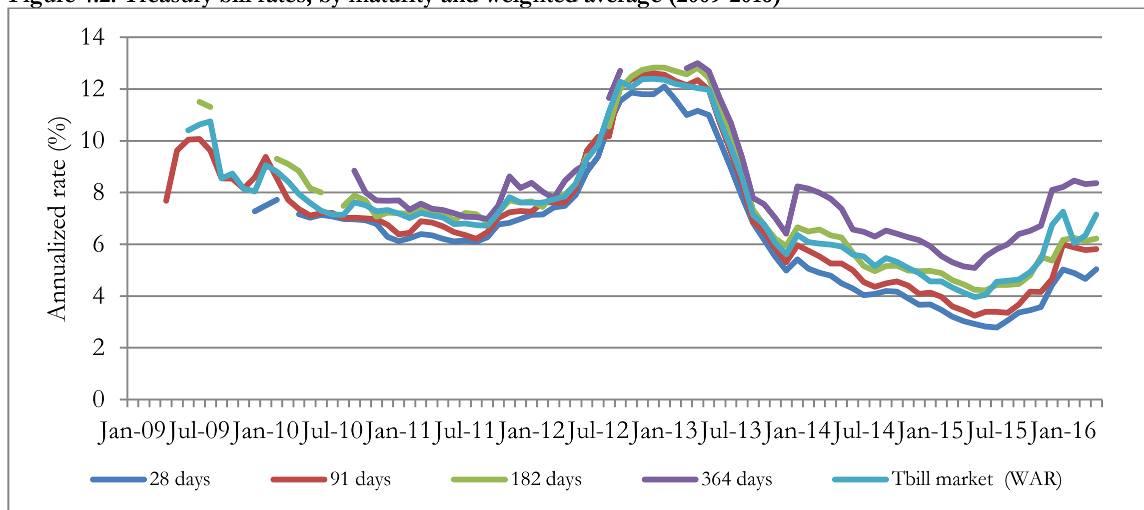
Table 4.1: Original, revised and executed Rwandan government budget (2012/13, RWF billions unless otherwise stated)

	Original budget	Revised budget	Executed budget	% Change original-executed budget
Revenues and Grants	***1220.60***	***1149.50***	***1101.30***	***-9.77%***
Total revenues	**724.40**	**707.70**	**736.40**	**1.66%**
Tax revenues	641.20	641.20	651.90	1.67%
Non-tax revenues	83.20	66.50	84.50	1.56%
Total Grants	**496.20**	**441.80**	**364.90**	**-26.46%**
Budgetary Grants	252.30	197.90	190.00	-24.69%
Capital Grants	243.90	243.90	174.90	-28.29%
Total expenditures and net lending	***1337.90***	***1424.90***	***1335.60***	***-0.17%***
Current expenditures	**680.80**	**634.60**	**633.90**	**-6.89%**
Wages and salaries	183.10	178.20	168.90	-7.76%
Purchases of goods and services	127.60	117.40	123.10	-3.53%
Interest payments	18.20	28.40	30.70	68.68%
Domestic	8.20	10.50	15.70	91.46%
Of which on overdrafts and bills	1.80		4.10	127.78%
External	10.00	17.90	15.00	50.00%
Transfers	266.20	238.20	230.80	-13.30%
Exceptional social expenditures	85.70	72.40	80.40	-6.18%
Development budget	**647.30**	**625.00**	**564.50**	**-12.79%**
Domestically financed	277.00	254.80	239.40	-13.57%
Foreign financed	370.30	370.20	325.10	-12.21%
Net lending	**9.80**	**165.30**	**137.20**	**1300.00%**
Change in arrears	-8.00	-8.00	-9.10	13.75%
Domestic	-8.00	-8.00	-9.10	13.75%
Overall deficit (cash basis)				
Including grants	-125.20	-283.40	-243.40	94.41%
Excluding grants	-621.40	-725.20	-608.30	-2.11%
Financing	***125.20***	***283.60***	***243.40***	***94.41%***
Foreign financing (net)	**128.40**	**355.50**	**338.60**	**163.71%**
Drawings	143.90	370.80	354.10	146.07%
Budgetary loans	17.50	17.40	16.20	-7.43%
Project loans	126.40	353.40	337.90	167.33%
Of which Eurobond	0.00	259.40	255.60	
Of which non-Eurobond	126.40	94.0	82.30	-34.89%
Amortization	-15.50	-15.30	-15.50	0.00%
Domestic financing	**-3.20**	**-71.90**	**-95.20**	**2875.00%**
Banking system	8.70	-84.40	-144.30	
Non-bank (net)	0.00	12.50	24.20	
Government securities	12.20	24.70	39.70	225.41%
Of which bills	12.20	24.50	39.50	
Of which bonds	0.00	0.00	0.20	
Non-bank sector debt repayment	-12.20	-12.20	-15.40	26.23%

Notes: Government budget for the July 2012-June 2013 fiscal year. Original budget as of June 2012, revised budget as of December 2012, and executed budget as of September 2013.
Source: Rwandan Parliament (2012), MINECOFIN (s.d. a; s.d. b; 2013c).

Such strategies have, however, not been without costs. The increased sale of Treasury bills by the government induced higher rates on the bills, as shown in Figure 4.2. Over the first half of the fiscal year, June-December 2012, the weighted average rate (WAR) on Treasury Bills increased from 9.3% to 12.4%. Ultimately, domestic interest payments on overdrafts and Treasury bills were more than double the amount originally budgeted (see Table 4.1). With donor disbursements again taking off following the signing of the Framework agreement, the issuance of Treasury bills returned to normal and their WAR declined to 10.8% by the end of the fiscal year (National Bank of Rwanda, 2013).

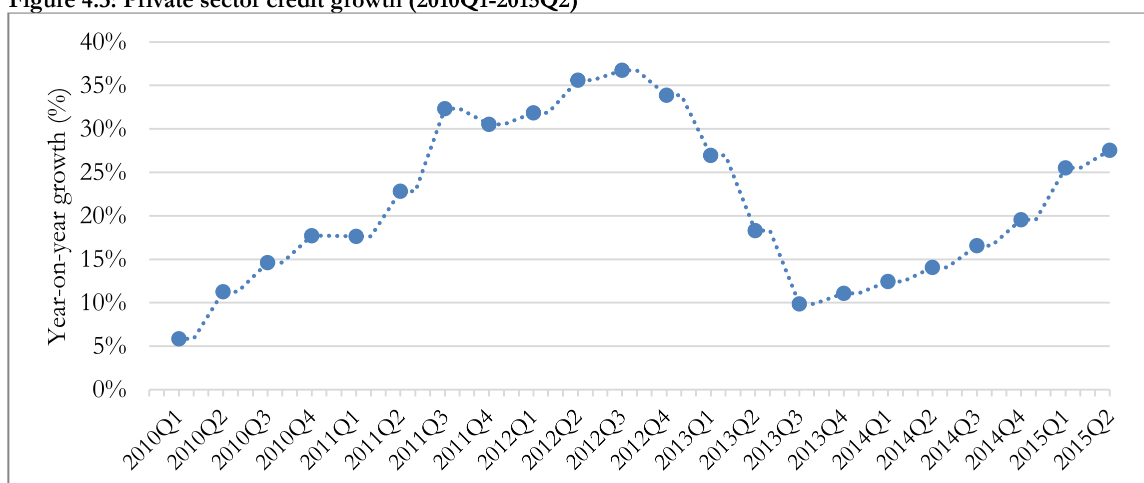
Figure 4.2: Treasury bill rates, by maturity and weighted average (2009-2016)



Source: National Bank of Rwanda.

Besides bringing about higher financing costs, the increased issuance of Treasury bills also removed liquidity from the economy. As commercial banks (and others) invested their resources in Treasury bills, growth in credit to the private sector decelerated during the second half of 2012 and early 2013, as shown in Figure 4.3. Lower private sector credit growth arguably translated into lower domestic demand for goods and services and reduced economic growth (see Table 4.3) (MINECOFIN, 2013c; World Bank, 2013c, 2015c).

Figure 4.3: Private sector credit growth (2010Q1-2015Q2)



Source: National Bank of Rwanda.

Finally, the issuance of Treasury bills also distracted the Rwandan government from lengthening the maturity of its domestic public debt stock, a key objective in its MTDS and structural benchmark in its Policy Support Instrument arrangement with the IMF, as Treasury bills crowded out longer-term bonds.[57] Whereas other factors may have played a role too, not a single Treasury bond was issued in 2012 or 2013. Only in 2014 did the government launch its new, quarterly issuance programme of bonds with increasingly longer tenors (see Section 3.2).

57 Rwanda's 2015-2016 MTDS makes explicit reference to the 2012 'aid cut shock' as one of the reasons for not achieving its maturity-lengthening goal.

Besides domestic debt, the aid suspension affected the timing and perhaps also the size of Rwanda's maiden Eurobond. Plans to venture into international capital markets were floated at least since 2011 and became more concrete in 2012, when a US$300 million Eurobond was put forward by then Finance Minister John Rwangombwa (Malingha Doya and Kay, 2012). However, after the 2012 aid suspension the Rwandan government waited a few months before going ahead with the issuance. It wanted to avoid investors making a direct link between the Eurobond and the budgetary gap left by donors, which would likely have resulted in higher interest rates.[58] In the end, a US$400 million rather than US$300 million Eurobond was launched. The extra US$100 million may have been (in part) to compensate for lower donor support, although there is no hard evidence for this assertion.[59]

The consequences of the aid suspension are also visible in Rwanda's balance of payments. As Table 4.2 shows, the shortfall in donor aid compounded the existing external imbalances, leading to a widening current account and overall deficit in 2012. This deficit was financed by an important decrease in the net foreign assets of the BNR, which fell by almost 20% and led to a depreciation of the Rwandan franc. The situation somewhat improved when aid resumed in the first half of 2013 and the country issued its Eurobond (World Bank, 2013b).

58 Interview, MINECOFIN, Kigali, 16 March 2016. That said, the Rwandan Eurobond prospectus document does go into quite some detail on the accusations made in the UN (draft) report and on the reactions of donors, citing future aid suspensions as a potential risk to payments under the Eurobond.

59 Officials themselves emphasized that the size of the Eurobond was primarily determined by the availability of good projects to finance. They stated that the main reason for not issuing a US$500 million or larger Eurobond, in spite of market pressures to do so (since it would make the bond eligible for benchmark indices like JP Morgan's EMBI Global), was the lack of another US$100 million worth of sufficiently developed projects at the time (Interview MINECOFIN, Kigali, 16 March 2016).

Table 4.2: Rwandan balance of payments (2006-2012; US$ millions)

	2006	2007	2008	2009	2010	2011	2012
Imports	450.9	583	890	999.2	1084	1565.8	1859
Exports	147.4	176.8	264.8	235	297.3	464.2	590.8
Trade balance	**-303.5**	**-406.2**	**-625.2**	**-764.3**	**-786.7**	**-1101.6**	**-1268.3**
Services and income (net)	-161	-140.4	-135.7	-218.4	-220.9	-161.5	-98.5
Trade and service and income balance	**-464.4**	**-546.6**	**-760.9**	**-982.7**	**-1007.6**	**-1263.1**	**-1366.7**
Current transfers (net)	325.5	461.3	518.6	604	580.8	797.8	632.1
Private	77.15	98.82	72.61	79.71	90.68	133.32	182.95
Remittances from diaspora	8.22	69.48	31.07	53.09	65.07	110.18	118.25
Private transfers for church and associations	68.93	29.34	41.54	26.62	25.61	23.14	64.7
Public	248.39	362.5	445.96	524.31	490.08	664.53	449.13
Incoming	251.13	366.38	450.08	531.67	503.44	674.94	463.43
Budgetary grants	128.35	259.27	339.76	415.84	402.92	545.72	343.32
Of which HIPC debt relief	21.97	4.5	5.6	5.21	4.53	4.53	4.79
Social security benefits	0	0	0	0	0	22.19	0
Non-budgetary grants	122.77	107.11	110.32	115.84	100.52	107.03	120.11
Of which technical assistance	51.61	26.78	27.58	28.96	25.13	26.76	30.03
Of which humanitarian aid	71.16	80.33	82.74	86.88	75.39	80.27	90.08
Outgoing (incl. contributions to international organizations)	-2.74	-3.88	-4.12	-7.36	-13.36	-10.41	-14.3
Current account balance (incl. official transfers)	**-138.88**	**-85.28**	**-242.3**	**-378.64**	**-426.82**	**-465.25**	**-734.63**
Capital and financial account balance	216	196.7	316.1	426.8	564.8	729.9	568.6
Errors and omissions	4.42	-0.75	-19.52	5.33	-65.9	-30.09	-46.38
Overall balance	**81.5**	**110.7**	**54.3**	**53.5**	**72.1**	**234.5**	**-212.4**
Financing (increase -)	-81.5	-110.7	-54.3	-53.5	-72.1	-234.5	212.4
Change in net foreign assets of NBR (increase -)	-81.5	-110.7	-54.3	-53.5	-72.1	-234.5	212.4
Net use of IMF credit (increase +)	2.5	3.3	3.7	3.6	0	-0.2	0
Change in gross reserves (increase -)	-35	-114.4	-58.7	-159.5	-69.1	-251.8	206.3
Change in other foreign liabilities (increase +)	-49	0.4	0.7	102.5	-3	17.5	6.1

Source: National Bank of Rwanda.

Finally, the aid suspension and its different macroeconomic and fiscal ramifications are believed to have had an impact on economic growth too. While growth averaged 8.2% between 2001 and 2012 and reached 8.8% in 2012, it slowed to 4.7% in 2013. Table 4.3 shows Rwanda's growth performance over 2001-2013 decomposed by sector. Agriculture, which accounts for a third of GDP, exhibited relatively low growth in 2013. Due to the bad harvest that year it contributed only 1% point to growth, compared to 2.2% points on average over 2000-2012. The impact is most visible in the food crops subsector. The industry sector grew at the same rate as its previous 12-year average. The aid suspension mainly impacted the tertiary/service sector, whose contribution is about half of GDP, both directly and indirectly. First, the aid shortfall slowed down growth in service subsectors through lower government expenditures. Second, the slower growth in private sector credit, due to the increased issuance of Treasury bills, also negatively impacted on the private consumption of services. Overall, the contribution of the service sector to overall growth fell from an average of 4.3% points over 2001-2012 or 5.4% in 2012 to 2.5% in 2013 (IMF, 2013; World Bank, 2015b; National Bank of Rwanda, 2013).

Table 4.3: Annual GDP growth, decomposed by sector (2001-2013)

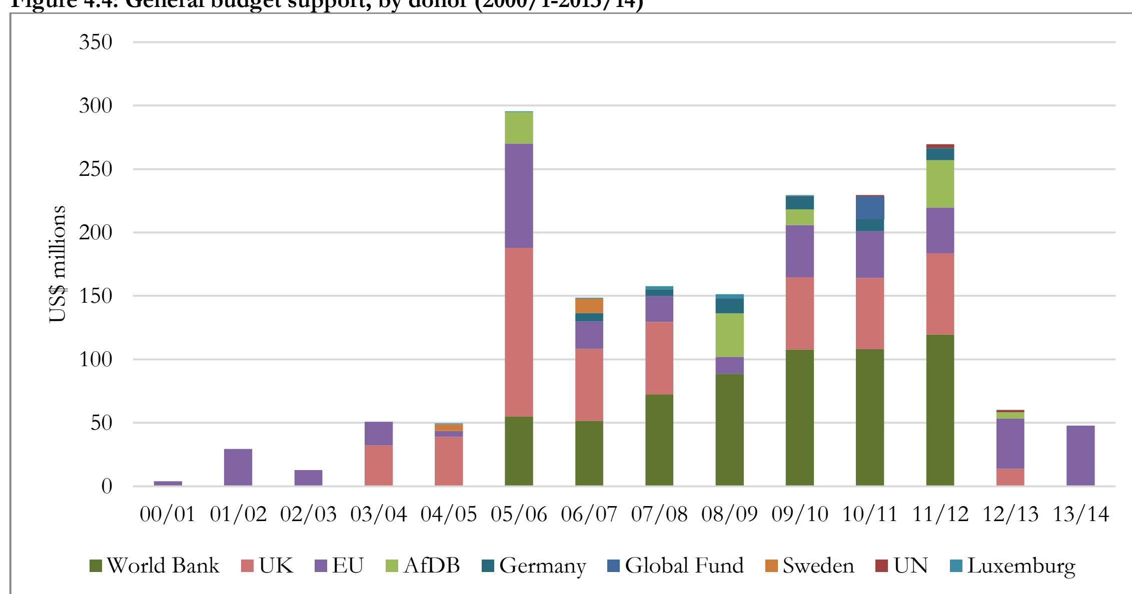
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	01-12 average	2013
GROSS DOMESTIC PRODUCT	8.5%	13.2%	2.2%	7.5%	9.4%	9.2%	7.6%	11.2%	6.3%	7.3%	7.9%	8.8%	8.2%	4.7%
AGRICULTURE. FORESTRY & FISHING	**3.7%**	**7.2%**	**-1.2%**	**1.0%**	**2.7%**	**1.3%**	**0.9%**	**2.3%**	**2.6%**	**1.7%**	**1.6%**	**2.1%**	**2.2%**	**1.0%**
Food crops	2.5%	5.9%	-1.3%	-0.9%	2.6%	0.0%	1.4%	1.3%	2.5%	1.1%	1.2%	1.6%	1.5%	0.8%
Export crops	0.4%	0.2%	-0.5%	1.4%	-0.8%	0.8%	-0.9%	0.6%	-0.3%	0.3%	0.1%	0.2%	0.1%	-0.1%
Livestock & livestock products	0.3%	0.3%	0.2%	0.1%	0.3%	0.1%	0.2%	0.1%	0.2%	0.1%	0.1%	0.2%	0.2%	0.2%
Forestry	0.5%	0.7%	0.5%	0.4%	0.6%	0.4%	0.3%	0.2%	0.2%	0.1%	0.2%	0.2%	0.3%	0.1%
INDUSTRY	**1.5%**	**0.8%**	**0.6%**	**1.9%**	**1.2%**	**1.5%**	**1.2%**	**2.0%**	**0.2%**	**1.1%**	**2.3%**	**1.2%**	**1.3%**	**1.3%**
Mining & quarrying	1.7%	-0.5%	-0.3%	0.8%	0.6%	-0.2%	0.8%	-0.3%	-0.3%	-0.2%	0.7%	-0.2%	0.2%	0.3%
TOTAL MANUFACTURING	*0.1%*	*1.0%*	*0.5%*	*0.7%*	*0.4%*	*1.0%*	*-0.2%*	*0.6%*	*0.2%*	*0.6%*	*0.3%*	*0.3%*	*0.5%*	*0.2%*
Electricity	-0.1%	0.0%	0.0%	-0.2%	0.0%	0.0%	0.0%	0.1%	0.0%	0.0%	0.0%	0.1%	0.0%	0.0%
Water & waste management	-0.2%	0.0%	0.0%	-0.2%	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%	0.1%	0.0%	0.0%	0.0%
Construction	0.0%	0.3%	0.5%	0.8%	0.3%	0.8%	0.5%	1.6%	0.2%	0.6%	1.3%	1.0%	0.7%	0.7%
SERVICES	**2.6%**	**4.3%**	**2.8%**	**4.2%**	**4.9%**	**5.7%**	**5.2%**	**6.1%**	**2.8%**	**4.2%**	**3.8%**	**5.4%**	**4.3%**	**2.5%**
TRADE &TRANSPORT	*0.9%*	*1.5%*	*0.2%*	*1.5%*	*1.5%*	*3.0%*	*2.0%*	*3.0%*	*0.8%*	*1.4%*	*1.1%*	*2.3%*	*1.6%*	*0.9%*
Maintenance and repair of motor vehicles	0.0%	0.1%	0.0%	0.0%	0.0%	0.1%	0.1%	0.1%	0.0%	0.0%	0.1%	0.0%	0.0%	0.0%
Wholesale & retail trade	0.6%	1.2%	0.1%	1.2%	1.1%	2.3%	1.5%	2.3%	0.5%	1.1%	0.9%	1.7%	1.2%	0.7%
Transport services	0.2%	0.3%	0.1%	0.3%	0.3%	0.6%	0.4%	0.6%	0.3%	0.2%	0.1%	0.5%	0.3%	0.2%
OTHER SERVICES	*1.7%*	*2.8%*	*2.6%*	*2.7%*	*3.5%*	*2.7%*	*3.2%*	*3.1%*	*2.0%*	*2.8%*	*2.7%*	*3.1%*	*2.7%*	*1.6%*
Hotels & restaurants	0.1%	0.4%	0.6%	0.5%	0.8%	0.6%	0.1%	0.2%	-0.1%	0.3%	0.2%	0.2%	0.3%	0.1%
Information & communication	0.2%	0.3%	0.1%	0.3%	0.3%	0.3%	0.3%	0.5%	0.2%	0.3%	0.2%	0.8%	0.3%	0.0%
Financial services	0.1%	0.0%	0.4%	0.3%	0.0%	0.2%	0.3%	0.1%	-0.1%	0.5%	0.6%	0.3%	0.2%	0.3%
Real estate activities	0.4%	0.5%	0.4%	0.3%	0.5%	0.3%	0.8%	1.1%	0.8%	0.3%	0.3%	0.0%	0.5%	0.1%
Professional. scientific and technical activities	0.1%	0.1%	0.1%	0.1%	0.2%	0.1%	0.3%	0.4%	0.3%	0.1%	0.1%	0.2%	0.2%	0.1%
Administrative and support service activities	0.1%	0.2%	0.1%	0.1%	0.2%	0.1%	0.3%	0.4%	0.3%	0.1%	0.1%	0.2%	0.2%	0.1%
Public administration and defence; compulsory social security	0.1%	0.1%	0.1%	0.1%	0.0%	0.3%	0.2%	0.1%	0.2%	0.4%	0.5%	0.6%	0.2%	0.3%
Education	0.2%	0.7%	-0.1%	0.4%	0.4%	0.1%	0.4%	0.2%	0.4%	0.3%	0.6%	0.2%	0.3%	0.1%
Human health and social work activities	0.1%	0.1%	0.2%	0.1%	0.0%	0.0%	0.1%	0.1%	0.2%	0.2%	0.1%	0.2%	0.1%	0.0%
Cultural. domestic & other services	0.1%	0.5%	0.6%	0.5%	1.0%	0.7%	0.6%	0.1%	-0.1%	0.4%	0.1%	0.4%	0.4%	0.4%
TAXES LESS SUBSIDIES	**0.7%**	**0.8%**	**0.0%**	**0.4%**	**0.5%**	**0.7%**	**0.3%**	**0.8%**	**0.7%**	**0.4%**	**0.1%**	**0.1%**	**0.5%**	**-0.2%**

Source: MINECOFIN.

4.2 Longer-term consequences

Beyond short- to medium-term impacts on Rwanda's public debt, fiscal and broader macroeconomic situation, the 2012 aid suspension also affected the longer-term relationship between the Rwandan government and its traditional donors. From 1999 onwards, and in line with donor preferences at the time, growing amounts of aid were disbursed to Rwanda in the form of GBS (EU, s.d.). As Figure 4.4 indicates, the EU and the UK were the first providers of GBS in Rwanda. The use of GBS increased significantly after the Rwandan authorities explicitly expressed their interest in this aid modality in 2006; between 2006 and 2011 up to US$200-300 million of GBS was disbursed annually.

Figure 4.4: General budget support, by donor (2000/1-2013/14)



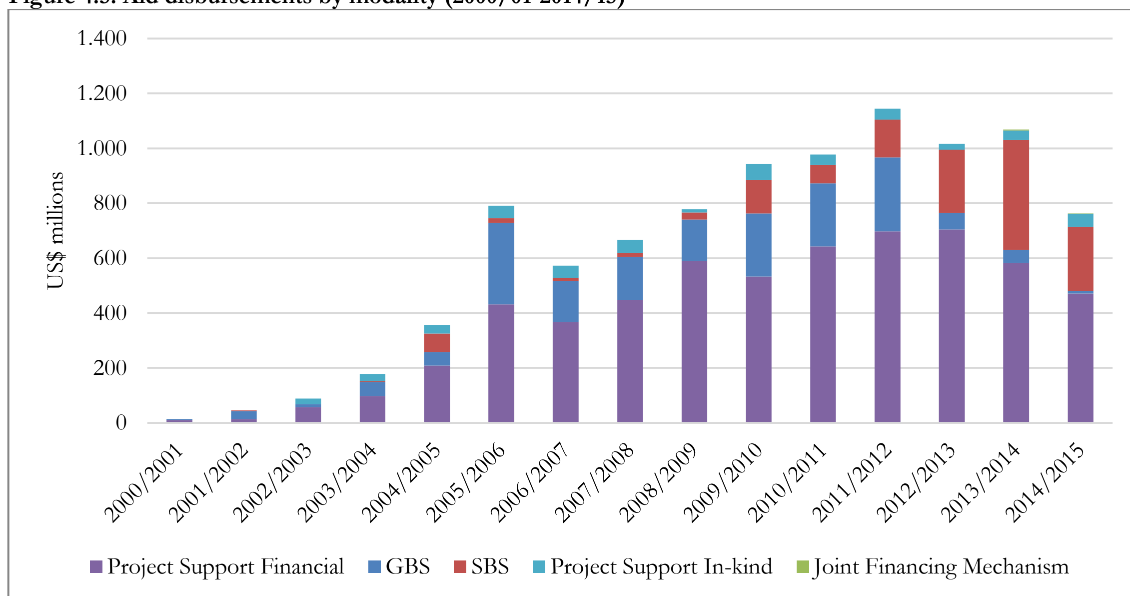
Note: The small amounts shown in early years are, to a large extent, due to limited donor reporting.
Source: MINECOFIN Development Assistance Database.

Following the 2012 aid suspension, both donors and the Rwandan government reconsidered their heavy reliance on the GBS modality. The Rwandan Parliament pointed to the problems caused by delays in or non-delivery of GBS. To avoid similar problems in the future, donors were asked to consider instruments that are more predictable and reliable. From the World Bank, for example, "the Government has requested more of the IDA17 allocation in the form of program for results (PforR) operations" (World Bank, 2014a). PforR links the disbursement of funds more directly to the achievement of pre-defined development results and largely delinks the disbursement from political conditionalities. Recently the World Bank even frontloaded PforR assistance to Rwanda as targets were reached earlier than planned (IMF, 2016a).

On the other side, different donors, including those that used to be its leading supporters, moved away from providing GBS. The World Bank, for example, formerly the largest provider of GBS-like support to Rwanda, has not presented any new demand for GBS to its Board since 2012. While the previous Country Partnership Strategy disbursed two thirds in the form of budget support, the newest strategy is "likely to disburse the same proportion as a mix of PforR and Development Policy Operations" (World Bank, 2014a, p40). In June 2014 DFID, formerly the largest bilateral provider of GBS to Rwanda, decided not to continue providing budget support, following an assessment of the Partnership Principles (DFID, 2014b, p10). The EU has also stopped providing

GBS to Rwanda for now. The 2014-2020 National Indicative Programme of the EU instead foresees SBS as the main aid modality in its three focal sectors (EU, 2014). The latest available aid disbursement figures by modality, shown in Figure 4.5, portray how GBS has fallen from grace in Rwanda (and the rise in SBS) since the 2012 suspensions.

Figure 4.5: Aid disbursements by modality (2000/01-2014/15)



Note: The small amounts shown in early years are, to a large extent, due to limited donor reporting.
Source: MINECOFIN Development Assistance Database.

Finally, the 2012 aid suspension heavily influenced the high-level dialogue structures between the Rwandan government and its donors. Following the delays and withdrawal of aid, the Rwandan government questioned the continuation of the Budget Support Harmonization Group (BSHG). Although donors saw the BSHG as an essential forum between SBS and GBS donors and the government to discuss general macroeconomic, fiscal and governance issues and review a common set of cross-sector indicators, the Rwandan government did not want to continue the group without receiving aid through GBS (Swedlund, 2015). In the end, the BSHG was dissolved. Discussions on the overall planning and budgeting process were shifted to the Development Partners Coordination Groups (DPCG), while sector-specific issues were referred to the 15 different Sector Working Groups. A new Public Financial Management (PFM) Coordination Forum was established in 2014, focussing on strategic level dialogue around PFM, a much narrower scope than the former BSHG. From the point of view of the donors, this left a void in terms of joint high-level, political dialogue with the Rwandan government on economic and governance issues (OECD, 2015).

5 | Debt management

Back when developing countries' public debt consisted almost exclusively of concessional, long-maturity bilateral and multilateral debt, debt management was relatively easy, and room for mistakes considerable. In case of serious debt repayment difficulties, traditional Paris Club creditors proved willing to provide several rounds of debt restructuring and, eventually (and disgruntledly), generous debt relief; so did multilaterals (Cassimon and Essers, 2013; Cassimon *et al.*, 2015).[60] As evident from the previous sections, Rwanda, like many other developing countries, now lives in a 'new age of choice', having access to a much broader range of public financing options (Prizzon and Mustapha, 2014). While this is a welcome development from the point of wanting to bring down traditional donor dependency and scale up growth-enhancing investment, it also makes managing the public debt portfolio much more complex. Rwanda needs to trade off very heterogeneous creditors (with different demands and sensitivities) and debt instruments (with different repayment modalities: local vs. foreign currency, short vs. long maturities, amortizations vs. bullet repayments, etc.) against each other Although new commercial creditors like Eurobond holders may perhaps not impose the same kind of (political) conditionalities as traditional donor-creditors have done or monitor the use of funds equally meticulously, they are likely to pay more attention to overall debt levels and other macroeconomic parameters and to be much more impatient than official creditors (Merotto *et al.*, 2015). In case the public debt situation derails, the former will not be equally forgiving as the latter. As has been painfully illustrated by the Argentina holdout saga, a multitude of commercial creditors can be difficult to coordinate in the event of default.[61]

To assist in achieving the best possible financing mix in terms of costs and risks (in addition to developing the domestic debt market and reducing aid dependency), the Rwandan MINECOFIN prepares a three-year MTDS document (updated annually on a rolling basis) where it sets out and compares different borrowing strategies, combining multilateral, bilateral and commercial external debt and short- and longer-term domestic public debt in various proportions. The MTDS is subsequently approved by Cabinet and included as an annex to the Medium Term Budget Framework. In collaboration with the BNR, MINECOFIN also undertakes its own Debt Sustainability Analysis (DSA) every year, in which it claims to be more conservative than similar DSA exercises by the IMF and World Bank.[62] In 2008 the World Bank conducted a first Rwandan Debt Management Performance Assessment (DeMPA), an on-demand tool designed to help countries improve public debt management capacity and identify reform priorities.[63] In line with the DeMPA's recommendations, Rwanda's MINECOFIN established a new Debt Management Unit (DMU), operational since 2014, that aims to bring together expertise previously scattered over different departments. At the moment, this DMU performs both the middle office (strategy and analysis) and back office (recording and reporting) functions of debt management, whereas the External Finance Unit of MINECOFIN and the BNR remain responsible for most front office tasks (debt negotiation and contracting). The incomplete coordination between MINECOFIN and the BNR, the DMU's relatively limited human resources (only five staff members) and

60 On the evolving nature of public debt restructuring and relief, see e.g., Cassimon and Essers (2013) and Cassimon *et al.* (2015).

61 In that sense, "Twenty-first Century Africa may… have more to learn from Latin America [which learned to manage its access to international capital markets the hard way] than from its own recent past" (Thomas and Giugale, 2015). Mozambique's ongoing tuna bond restructuring is also illustrative of the tensions with and between commercial creditors that could arise (see Wallace and Hill, 2016).

62 Interview, MINECOFIN, Kigali, 16 March 2016.

63 The World Bank was therein assisted by the Macroeconomic and Financial Management Institute of Eastern and Southern Africa (MEFMI), a regionally owned institute specialized in public debt management. Rwanda's first DeMPA report is classified as strictly confidential, at the request of country authorities.

inexperience, and a lack of transparency/reporting on some debt-related statistics, are considered to be the main weaknesses of current Rwandan debt management.[64] A second DeMPA mission was conducted in July 2015, with the results and associated reform plan to be finalized in the second half of 2016.[65]

64 Interviews, World Bank and MINECOFIN, Kigali, 15-16 March 2016.

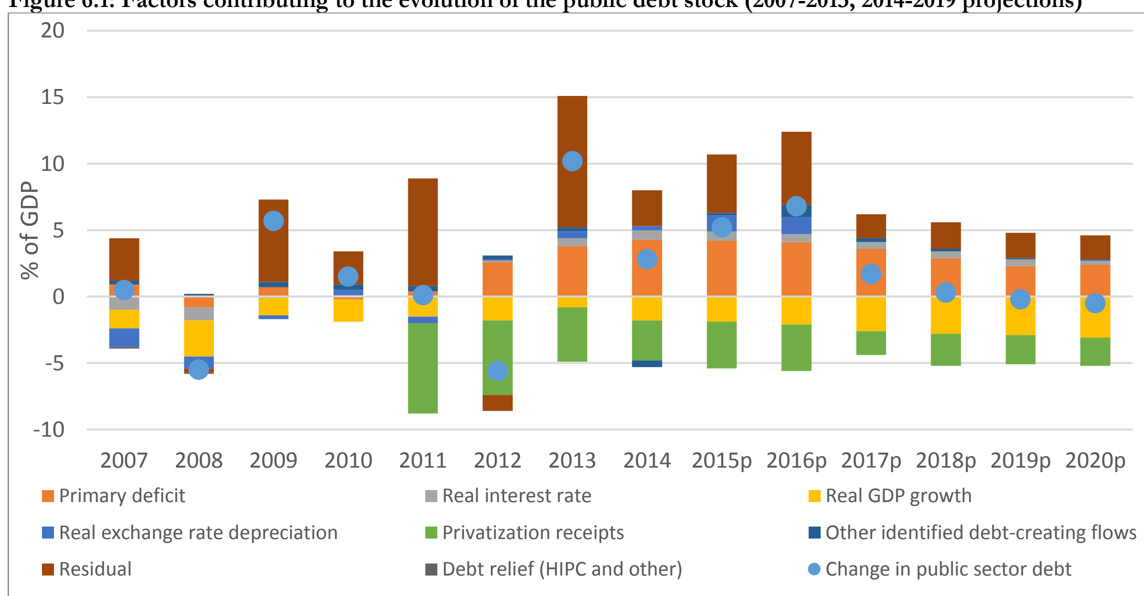
65 Judging from the World Bank's Country Policy and Institutional Assessment (CPIA), overall Rwandan debt management seems to be assessed quite favourably. Since 2013 the country has scored 4 out of 6 points on the CPIA's 'debt policy' sub-dimension, which evaluates whether budgetary risks are minimized and long-term debt sustainability is ensured by existing debt management practices. This score trumps that of Burundi (3), the DR Congo (3.5) and the Sub-Saharan African average (3.2) and is on a par with Tanzania. However, fellow EAC countries Kenya and Uganda (both 4.5) perform slightly better.

6 | Future debt sustainability

Ever since December 2013, the IMF and World Bank's Debt Sustainability Analyses (DSAs), have consistently classified Rwanda as having a 'low risk of debt distress', meaning that under the DSAs' baseline scenario and several stress tests all public debt stock and debt service indicators are projected to remain below their indicative thresholds (see Cassimon *et al.*, 2016).[66] One exception to this concerns the bullet repayment of the Eurobond, which implies marginal, one-year breaches of the threshold debt-service-to-exports and debt-service-to-revenue ratios in 2023 when scenarios of export shocks or large currency depreciations are considered. But given the assumption that Rwanda will be able to refinance the maturing Eurobond somewhere around 2020, in view of its low debt levels overall and provided that macroeconomic and fiscal prudence are maintained, these temporary breaches have not altered the IMF and World Bank's end conclusion about the low likelihood of debt distress (IMF, 2016a).

To inform our analysis of the key vulnerabilities of Rwandan debt sustainability, we start by looking at the fiscal and macroeconomic factors that have driven total and external public debt dynamics in the past, according to the IMF and World Bank's DSAs for Rwanda. Figure 6.1 decomposes the total public debt stock's evolution into its contributing factors. On the upper side it shows the factors that contributed to an increase in the public debt to GDP ratio (e.g., the primary fiscal deficit), and on the lower side the factors that had a negative impact on this ratio (e.g., positive real GDP growth). The dots in Figure 6.1 represent the combined effect of all the different factors listed, i.e., the actually observed annual increases or decreases in public debt to GDP.

Figure 6.1: Factors contributing to the evolution of the public debt stock (2007-2013, 2014-2019 projections)

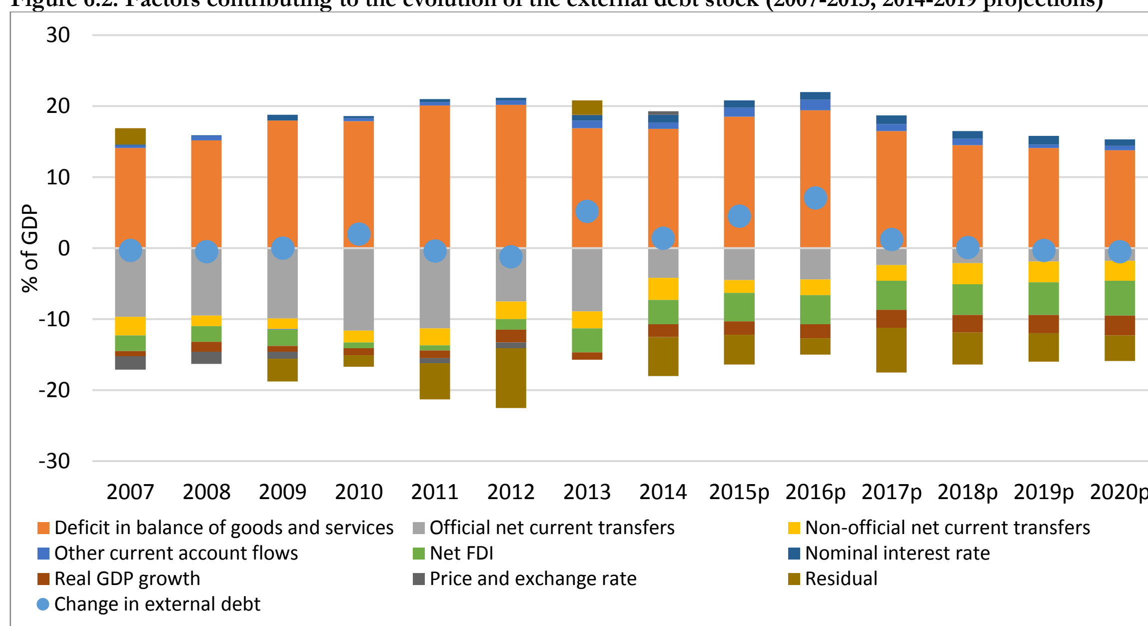


Source: Authors' calculations based on IMF-World Bank DSAs.

66 Between HIPC/MDRI completion point (2005/2006) and 2013, Rwanda's risk of debt distress was deemed 'moderate' rather than 'low', as stress tests indicated violations of the debt-to-exports threshold. A major factor underlying the 2013 upgrade to 'low risk' was the gradual improvement in Rwanda's overall CPIA score, assigned by the World Bank. As a strong performer on the CPIA (a three-year moving average score of more than 3.75 out of 6), Rwanda's debt sustainability is now evaluated against higher thresholds than before. Also, since October 2013 the IMF and World Bank use a fixed, unified annual discount rate of 5% in their DSAs, instead of the (currency-specific) 3% previously. This decision has lowered the present value of Rwandan external debt mechanically. See IMF (2013) for more details.

Figure 6.1 suggests that privatization receipts and real GDP growth have been the most important downward forces on public debt-to-GDP. Privatization receipts are, logically, expected to decrease in the projections, while growth is still considered to be significant in the near future. Conversely, the DSAs identify the primary fiscal deficit (excluding interest payments but including grants) as a key contributor to the increase in public debt stock. The projections assume an increase in domestic revenue which compensates for the expected decrease in grants, while primary expenditures are assumed to slightly decrease. As a result, the primary deficit is expected to shrink in the future (IMF, 2016a). The residual term, which combines debt-contributing factors other than the ones listed in the legend of Figure 6.1, is surprisingly large and positive. IMF (2016a) explains the residuals in 2015 and 2016 with reference to the fact that publicly guaranteed non-concessional loans are excluded from the fiscal accounts. While this could also explain part of the residuals in earlier years (before 2013, when guaranteed loans were partially repaid with the Eurobond proceeds), it is unlikely to account for the full residuals. Recent research on public debt dynamics finds that large positive changes in debt are often the result of so-called 'stock-flow adjustments', rather than high primary deficits or output declines. These stock-flow adjustments, which tend to be higher in countries with lower institutional quality, may be due to the underreporting of fiscal deficits, the use of quasi-fiscal spending, the materialization of contingent liabilities or the net acquisition of financial assets by the government (Jaramillo *et al.*, 2016). It remains unclear whether the large residual terms in Figure 6.1 can be ascribed to any (or a combination) of these factors.[67]

Figure 6.2: Factors contributing to the evolution of the external debt stock (2007-2013, 2014-2019 projections)



Source: Authors' calculations based on IMF-World Bank DSAs.

Figure 6.2 looks at the factors contributing to the evolution of the external public debt stock. It shows that the deficit in the balance of goods and services, due to limited exports and high imports, contributes most to increases in the external debt-to-GDP ratio. Given Rwanda's high investment/import needs and weak commodity prices on international markets, this factor is projected to remain important in the near future. In 2015 and 2016 the deficit was expected to further increase due to weaker mineral exports. From 2017 onwards, the deficit is projected to

67 On several occasions we have asked Rwandan authorities and IMF staff familiar with these matters to expand on the likely origins of these large residual terms; without any success, however.

gradually diminish as policies designed to expand and diversify the export base bear fruit (IMF, 2016a). Official net current transfers, mostly aid, have contributed to decreases in the external debt stock. In line with the government policy to reduce its reliance on aid, the importance of this factor is expected to decline in the projections. Net inflows of FDI, on the other hand, are assumed to become more important. Unlike in Figure 6.1, the residual term in Figure 6.2 is negative in most years.

Given its small domestic public debt stock, Rwanda's debt vulnerabilities lie mostly in its external position. As recognized by the international financial institutions and the government itself, the main risk to public debt sustainability relates to the generation and use of scarce foreign exchange. To better understand the issues at stake, it is informative to look at both the demand and supply side of foreign exchange.

Large public infrastructure investments, which tend to have a significant import component, are an important draw on foreign exchange in Rwanda. Even if lower oil prices since late 2014 have helped to contain the overall growth of the import bill, imports of capital goods and construction materials have remained strong. Of course, the idea behind much of this public infrastructure investment, such as the building of luxurious hotels and conference venues with international appeal or an expansion of international transport facilities, is that these will generate foreign exchange once completed. As a matter of fact, since a number of years tourism has been the single largest source of foreign exchange for Rwanda. Between 2010 and 2014 total tourist numbers and receipts grew at average annual rates of about 20% and 10%, respectively (World Bank, 2015b). The example of the much-delayed, cost-inflated KCC (see Section 3.1.3) shows, however, how the matching of foreign exchange demand and supply can be (temporarily) disrupted. The KCC project kept on demanding foreign exchange beyond what was originally planned (because of problems in project implementation, including extra audits and a switch between construction firms) while not yet supplying additional foreign exchange (from business tourists). Hence, increasing the efficiency of public investment will be crucial to better match foreign exchange demand and supply and ensure future debt sustainability.[68]

To improve this efficiency, the Rwandan government has recently elaborated a Public Investment Programme (PIP) in dialogue with its development partners. The PIP explains the government's priorities, phasing and expected financing. Highest priority is given to projects for water, energy and affordable housing but also to the expansion of RwandAir, including the construction of a new international airport in the medium term (IMF, 2014c). To finance these investments different financing options are considered, both concessional and non-concessional. While the links between the PIP and the government's Medium Term Expenditure Framework have recently been strengthened, management of the PIP needs to be improved at all stages to ensure that fiscal risks are contained and debt sustainability maintained (IMF, 2015). Given the problems it has had with project implementation in the past, the Rwandan government plans to issue its second Eurobond only when projects are in an advanced state of preparation. In this way, projects should more rapidly generate foreign exchange that can be used to repay the debt contracted to finance them.[69]

68 Clark and Arnason (2014) present a formal model of this argument in the Rwandan context. They provide simulations of how Rwanda could maintain high growth rates, to attain MIC status, while simultaneously reducing aid dependency. Alternative financing options they consider, including higher consumption taxes, external commercial borrowing or a combination of the two, generally lead to unsustainable public debt in the longer run. In their model, improvements in the 'efficiency of public investment', i.e., the share of every dollar spent on public infrastructure that is turned into productive public capital (which enters firms' production functions), are needed to keep public debt on a sustainable path.

69 Interview, MINECOFIN, Kigali, 16 March 2016.

Other than on tourism, a component of service exports, the supply of foreign exchange depends on aid and the exports of goods. IMF (2014b), for example, shows a strong correlation of aid with Rwanda's international reserves coverage. While Rwandan authorities' desire to reduce their reliance on traditional donor aid may lessen foreign interference in domestic policies, it will also put extra pressure on foreign exchange reserves and complicate public debt sustainability. Moreover, as donors shift away their aid from untied, non-earmarked budget support operations to project-style interventions, it could be that part of the incoming foreign exchange is siphoned off to pay for project-related imports (from the donor or a third country).

Rwandan goods exports have been traditionally dominated by coffee, tea and minerals such as cassiterite (tin ore) and coltan (columbite-tantalite, used in capacitors of electronic devices), commodities that expose the country to large international price fluctuations.[70] Indeed, recent developments showcase very well the associated vulnerabilities. The global fall in commodity demand and prices, which has intensified since late 2014, led to a 43% decline in Rwanda's export earnings from cassiterite and coltan between 2014 and 2015; higher coffee and tea exports could only partially compensate for the foreign exchange losses. As the total import value did not drop equally rapidly in the meantime, the Rwandan franc came under pressure and official foreign exchange reserves dwindled to less than four months of import cover, before recovering end 2015.[71] The first months of 2016 have seen still lower mineral exports and further exchange rate depreciation. These are trends that holders of dollar-denominated Rwandan debt, like Eurobond investors, will watch closely and which also lay at the basis of the recent decision by Standard & Poor's to change Rwanda's sovereign rating outlook from stable to negative (MINECOFIN, 2016).

In June 2016 the Executive Board of the IMF approved an 18-month arrangement of US$204 million for Rwanda under the Stand-by Credit Facility (SCF). Half of this amount was immediately made available to bolster international reserves. In the memorandum of economic and financial policies accompanying the request for the SCF arrangement Rwandan authorities commit to higher exchange rate flexibility, a more restrained fiscal policy and import compression as short-term measures to mitigate external pressures (IMF, 2016c). Over the medium to longer term, however, Rwanda will have to expand *and* diversify its exports of goods and services if it is to keep (external) public debt sustainable. To this end, the Rwandan government has already taken a number of initiatives. It is investing heavily in the infrastructure needed to attract more high-end tourism and business events, including hotels and international transport facilities. As pointed out above, the projects financed with the Eurobond proceeds fit neatly within this strategy, although actual project implementation leaves much to be desired. Also, the government is attempting to develop non-traditional, higher value-added exports, such as horticultural and milling products, mainly destined for regional markets (which would help to diversify in terms of export partners too). In 2014 and 2015 these non-traditional exports grew substantially, although they still make up no more than one fifth of the total value of exported goods (IMF, 2016a).

70 For a detailed overview of the composition of Rwanda's exports over 1998-2014, see http://www.bnr.rw/index.php?id=212, visited on 19 April 2016.

71 Whereas the Rwandan franc has depreciated against the US dollar (by 7.6% over 2015), it has *appreciated* against the currencies of its fellow EAC member countries. In 2015 the BNR used a substantial amount of its foreign exchange reserves in sales to local commercial banks (which had depleted their own reserves), in order to support the exchange rate (see IMF, 2016a). The BNR has accused exchange bureaus of speculating against the Rwandan franc by hoarding US dollars to create artificial shortages. See New Times, 30 July 2015.

7 | Conclusion

This paper has studied how Rwanda public debt has evolved after having benefited from large relief operations in 2005-2006. Overall it appears the Rwandan government has fared a prudent course in re-accumulating debt to finance its development. Whereas in absolute terms total public debt now again surpasses its pre-relief levels, the relative debt-to-GDP ratio is still only a third of what it used to be before the HIPC initiative. Moreover, highly concessional multilateral loans continue to dominate Rwandan public debt, which, together with favourable institutional assessments, helps to explain the 'low risk of debt distress' label Rwanda has been awarded with by the IMF and World Bank.

At the same time, however, Rwanda has ventured into non-traditional, alternative forms of public debt, in view of diversifying its debt portfolio and reducing its reliance on traditional donor support over the medium to longer term. First, Rwanda has increasingly sought credit from non-Paris Club bilaterals, including EXIM China and India. Second, with its maiden 2013 Eurobond the country has made a (relatively successful) entry into international capital markets, although the real test will come when this large bond needs to be refinanced. And third, Rwanda has gradually stepped up its efforts in developing a domestic market for longer-term local currency Treasury bonds, which remains very small to date.

While such debt diversification is a laudable (and perhaps necessary) strategy with various advantages, experimentation with different, yet-to-be optimized debt instruments means Rwanda is leaving money on the table, at least in the short run. More so than before debt relief, Rwanda now faces difficult trade-offs between heterogeneous creditors and debt instruments, complicating debt management. The transition to a new equilibrium of a well-balanced and sustainable debt portfolio has not been and will not be, in the foreseeable future, without 'hiccups'.

Our case study of the 2012 aid suspension following the publication of a critical UN report has illustrated some these transition problems. The direct impact of the suspension was visible in a number of broader fiscal and macroeconomic domains (including budgetary cuts, lower private sector credit growth and a decline in foreign exchange reserves). More indirectly, it affected the timing and possibly also the size of Rwanda's first Eurobond issuance and hampered the deepening of the local Treasury bond market. While most of these effects were relatively quickly overturned once donor aid resumed, the suspension seems to have led to a more permanent shift in aid modalities, away from GBS, and in the dialogue structures between the Rwandan government and its traditional donors.

There are a number of things Rwanda and its development partners could do to help keep public debt sustainable and to smoothen ongoing debt portfolio transitions. First of all, the growing complexity of Rwanda's debt composition requires greater debt management capacity. Given its limited size and experience, the recently established DMU would probably benefit from extra human resources and further capacity building. On the domestic debt side, the buy-and-hold of local investors and lack of regional participation in Rwandan Treasury bonds implies that costs are currently higher than what they could be. Therefore Rwanda would do good to make use of all the technical assistance that organizations such as the World Bank, IMF and others offer with respect to financial market development. Of course, efficient domestic (and, by extension, regional) government bond markets are not built overnight, and Rwanda is right in moving cautiously, keeping an eye on potential crowding out of credit to the private sector. The Eurobond experience,

on the other hand, has shown how also project appraisal and implementation can be much improved and how such instruments expose Rwanda to refinancing risk and large, time-concentrated claims on scarce foreign exchange over a long planning horizon. It is one thing to present an attractive and coherent story to external commercial creditors. Putting in practice projects that will generate sufficient foreign exchange to (at least) cover their own financing is quite another. Finally, future debt sustainability will be largely made or broken by how successful Rwanda is in expanding and diversifying its exports. Again, this is something that will not come without struggle but which could be supported by extra resources and advice from development partners.

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