FISCAL PERFORMANCE IN 2006

INTRODUCTION

Fiscal performance in 2006 was mixed. On one hand revenue collections were buoyant and exceeded budgetary targets. On the other hand expenditures also expanded as Government had to provide funding for some unanticipated priority and sovereign expenditures during the year. However because the excess revenue collection was higher than the increase in spending, the domestic fiscal deficit (excluding outlays for external interest, externally financed capital, demobilization and for AU peacekeeping) though higher than in 2005, was slightly lower than originally projected for 2006. The attached Tables 1, 2A, 2B and 2C show details of fiscal performance in 2006 compared to the budget and PRGF estimates. Whilst Table 1 shows the resource envelope and outlays Tables 2A, 2B and 2C show the economic classifications of fiscal performance.

I. RESOURCES OF CENTRAL GOVERNMENT

i. Domestic Revenue Performance

a. Tax Revenue

The table below shows the tax revenue performance for 2005 and 2006.

Tax revenue Performance in 2005 & 2006

	2005	2006
Tax revenue	**162,624.5**	**193,614.1**
Direct taxes	**50,688.2**	**64,504.9**
Companies	23,815.8	26,810.0
Individuals (PAYE)	**25,471.4**	**35,716.4**
Others and Property taxes	1,400.9	1,978.5
Taxes on goods and services	**82,900**	**95,536.9**
Excise taxes	20 ,913.1	23,253.1
Value Added Tax	**57,746.9**	**67,152.6**
Road Fund	4,240.1	5,131.2
Taxes on international trade	**29,070**	**33,572.3**
Import tax	22,071.0	23,923.9
Other (Incl Magerwa , demurrage and Electrogaz	7,001.8	9,648.4

Total domestic tax and non tax revenue collected in 2006 amounted to RWF 193.6 billion compared to RWF188.6 billion in the revised budget and RWF 183.6 billion in the PRGF program. Actual collections in 2006 were therefore about RWF 5.1 billion more than the figure approved by Parliament in the revised budget and about RWF 10 billion higher than the PRGF target.

In general tax revenue collections benefited from the buoyant economic activity especially in manufacturing as well as in the services sectors. However the excess collections came mainly from P.A.Y E and VAT. In the case of PAYE, the strong performance continue to benefit from the application of the income tax law that broadened the tax base by including fringe benefits as well widening of the tax net to rope in new taxpayers. Regarding VAT, the monetary injection from the budget (the domestic fiscal deficit alluded to above) and from the private sector (increase in bank credit) into the economy boosted the demand for goods and services that are taxable and increased VAT collections. With total collections of RWF 102.9 billion (RWF 35.7 billion from PAYE and RWF67 billion from VAT), the two tax heads represent about 54% of domestic tax collections in 2006. In 2005 the two tax heads contributed RWF83.2 billion about 51% of total tax collections of RWF162 billion. (See above table of tax collections in 2005 and 2006).

The high contribution of PAYE and VAT to tax collections is in line with Government social policy of getting the "wealthier" people in society to contribute a larger share of the tax burden. These two tax items are expected to continue to play a vital role in domestic resource mobilization in the future.

Despite the improved tax collections in 2006, note is to be taken of the stagnating role of taxes on international trade especially import taxes in revenue mobilization. Whilst total imports rose by about 21% in 2006 over the figure for 2005, total collections from taxes on international trade at RWF 29 billion in 2005 showed only an increase of about 15% to RWF 33.6 billion in 2006.

This lower increase is due to a number of factors. First there has been a shift in the composition of imports, with the share of capital goods rising. This is good for the economy as there is the need to increase investment for growth. Since these goods are not taxed, they reduce the taxable base. This trend is expected to continue as investment is expected to grow. Second, an increasing share of imports is originating from the COMESA free trade area which reduces the taxable base still further. In 2006, it is estimated that about 53% of finished goods imports came from the COMESA free trade area. The taxable base is also expected to be reduced further when Rwanda joins the EAC. Third the Rwandese franc appreciated against the US dollar by about 4% in 2006 and also reduced the taxable base. This trend is also expected to continue in the next few years especially if the "scaling up" of aid to Rwanda is effected. Fourthly, the MAGERWA fees have been abolished and replaced with a flat fee which may not yield much revenue. Future tax policies as well as tax estimates will therefore have to take these developments regarding import taxes into consideration.

b. Non tax Revenue

Collections from non-tax revenue at RWF 14.6 billion exceeded the revised budget target of RWF 11.8 billion by RWF 2.8 billion. Collections from "one off" items such as proceeds from the sale of the remaining Government vehicles, proceeds from the sale of strategic stocks fuel and the remaining payment from the sale of the police plot accounted for this over performance.

c. External Resources

The attached table 3 shows expected external budgetary resources and actual receipts.
In 2006, the Government expected external resources for the budget of US$ 131.9 million .This amount included US$ 9.3 million as HIPC grants , US $ 14 million from the AU as reimbursement for the Darfur peacekeeping operations and US$ 11 million as grants from Multi-donors (including UK and Germany) to fund the demobilization exercise. At end 2006, total receipts amounted to US$ 146 million. Despite shortfalls notably from the Multi-donors for demobilization and from the AU for the peacekeeping operations there was an excess of about US$ 14 million.

This excess came primarily from a loan of US$7.98 from the AFDB and the provision of US$ 24.8 million in HIPC grants. In the case of the AFDB loan, this was not included in the budget estimates. Regarding the HIPC grants, partial data underestimated the figure at US$ 9.3 million during the budget exercise.

Furthermore data from BNR shows total disbursements (loans and grants) of US 150.7 million for the financing of the externally supported capital budget. This amount therefore met the target. Regarding implementation, data gathering exercise by CEPEX is still in progress and should be finished soon to provide an accurate overview.

In addition to these cash receipts, the cancellation of Rwanda's debt to the IMF under MDRI led to the accrual of RWF 42.4 billion to Government deposits in BNR and can be used to finance future priority expenditures.

II. GOVERNMENT OUTLAYS

As indicated above the attached tables 1 and 2A, 2B and 2C show the details of fiscal performance in 2006.

a. Economic classification outturn.

As shown in Table 1 total Government outlays for 2006 by economic classifications amounted to RWF 417.2 compared RWF 388.4 billion in the PRGF program and RWF 396 billion in the revised budget. Higher spending in respect of interest payments, Transfers and subsidies, domestically financed capital and arrears were partially offset by lower spending on debt payments.

Regarding interest payments, the overspending of RWF 0.8 billion was mainly on account of higher interest payments on Treasury bills sales by both GOR and BNR for monetary policy purposes. As a result of these sales BNR was able to meet the reserve money target for 2006.

In the case of transfers, the excess expenditure was on account of purchase of fuel for Electrogaz costing RWF1.9 billion and a transfer RWF 1.5 billion to deposit holders of the recently closed Micro-finance Institutions (MFI's). These expenditures were not included in the revised budget.

With regard to domestically financed capital expenditure, the excess spending was partly on account of excess payments made for the completion of the RRA building (RWF 2.5 billion) and construction of various school blocks (RWF 0.6 billion). In addition an amount of RWF 1.6 billion was made as down-payment for the Kigali Water Project, whilst RWF 0.4 billion was spent by MINAGRI on a cattle project. These last two priority projects were not in the revised budget.
On arrears the overspending was mainly due to excess payments in respect of land compensation.

On the issue of foreign financed capital spending, the amount of RWF 83 billion which is equal to the budgeted figure is an estimate. A final report on implementation is awaited from CEPEX. Note however is to be taken of the fact that in 2006 receipts from the donors for implementation of this portion of the capital budget recorded in BNR's cashflow amounted to RWF 83 billion (US$150.7 million).

In the external sector, there was an under-spending in respect of external principal debt payments. In the revised budget an amount RWF 9.1 billion was allocated. As a result of the implementation of the MDRI however GOR made cash payments of only RWF2.8 billion.

b. Functional classification analysis

2006 BUDGET EXECUTION BY FUNCTIONAL CLASSIFICATION

	ACTUAL 2006	Share
EXECUTIVE & LEGISLATIVE ORGANS	19 003 932 174	6,6%
OTHER GOVERNMENT SERVICES	53 314 095 252	18,6%
DEFENSE	31 749 671 792	11,1%
PUBLIC ORDER AND SAFETY	21 098 784 815	7,4%
AGRICULTURE	14 557 194 224	5,1%
INDUSTRY AND COMMERCE	9 048 447 937	3,2%
FUEL AND ENERGY	17 109 750 319	6,0%
TRANSPORT AND COMMUNICATION	14 683 310 339	5,1%
LAND HOUSING & COMMUNITY AMENITIES	5 032 830 260	1,8%
WATER, SANITATION AND ENVIRONMENTAL PROTECTION	6 043 319 514	2,1%
YOUTH CULTURE AND SPORTS	2 444 803 135	0,9%
HEALTH	17 566 332 470	6,1%
EDUCATION	61 030 574 745	21,3%
SOCIAL PROTECTION	13 912 128 644	4,9%
Total	**286 595 175 620**	**100,0%**

Footnote:
Some totals differ from the Economic classification totals due to Some cross cutting MINECOFIN expenditures includes outlays for AU Peace keeping operations

The table above shows total primary expenditure amounting to RWF 286.5 billion by functional classification for 2006. As can be seen and in line with Government policy, outlays for education at RWF 61 billion took the largest share at about 21 % of total expenditure. Wages and salaries for teachers, transfer of funds to the districts for capitation grants, for feeding of school children and for the supply of books and other essential materials took a large share of this spending. In addition a significant amount was spent on repairs and maintenance as well as on construction of new schools in the country. Other Government services including outlays for the AU peacekeeping operations took about 19% of total spending. Defense spending took 11% share of total outlays. A large share of this expenditure was used for the full implementation of the public sector wage reform by the military. Public order and safety and the executive and legislative organs each spent about 7% of outlays.

Total spending in the fuel and energy and health sectors took about 6 % of total outlays each. In the case of the fuel and energy sector spending on the Lake Kivu gas project as well as on other energy saving devises accounted for a large share of spending. Concerning health expenditure the relative low share of Central Government's spending is due to the fact that a large portion of total expenditure in the health sector is funded by external donors. Their projects and programs as well as the funding are not included in the Central Government's budget. Funds from the Central Government in 2006 were largely spent as transfers to the district health centers to cater for their running costs. These included the payment of wages and salaries, provision of drugs and equipment as well as catering for "mutuelle" insurance services and contractual approach programs where required.

Expenditure in the agriculture and the transport and communications sectors as well as for social protection each accounted for about 5% of total expenditure. With respect to the agriculture sector, outlays for extension services, terracing for soil conservation, livestock development and crop research programs accounted for the largest share of spending. Regarding the transport and communications sector expenditure on roads repairs and maintenance and ICT related spending were the most important portions. In the case of social protection, transfers to FARG (amounting to about 5% of budgeted domestic revenue as agreed by law) and spending on vulnerable groups including orphans accounted for most of the expenditure.

Shares for industry and commerce and water, sanitation and environmental protection amounted to about 3% and 2% respectively. Outlays for export promotion activities took the largest share in the commerce and industry sector. Some of the activities financed with Central Government funds include the provision of technical assistance and other facilities in the construction of a number of coffee washing stations, upgrading of some OCIR-The factories and provision of extension services for some tea out-growers as well as providing assistance in the building of specialized cold storage facilities for non-traditional exporters. In the water, sanitation and environmental protection sector expenditure on water supply (including the Kigali water supply system) was the major item.

Priority Spending

The attached table 4 gives the details of priority expenditure by economic and functional classifications.

The table below shows a summary of the attached table 4.

	Budget Actual (in bil RWF)	Actual (in bil RWF)
Recurrent expenditure	126.2	127.6
Domestic capital	14.2	19.0
Net lending (Lake Kivu project)	3.7	4.1
TOTAL	**144.1**	**150.7**

The table shows that the priority spending was exceeded by about RWF 7 billion with contributions from all the three areas. In the case of recurrent expenditure the excess was largely contributed by outlays for roads repairs and maintenance as well as for export promotion programs and projects alluded to above. Regarding domestic capital the excess reflected payments for the completion of some school classroom blocks, the down-payment of RWF 1.6 billion for the Kigali Water Project and the new cattle project for MINAGRI costing RWF0.4 billion. As shown in the summary table above the expenditure on the gas project and other related costs were responsible for the excess expenditure under net lending.

III. DEFICITS AND IMPACT ON MONETARY DEVELOPMENTS

Annex table 2 shows the deficits i.e excluding grants, including grants and the domestic deficit. Expected external budget support was on track for 2006. As a result of the better performance of domestic revenue collections the outturn with respect to all the deficits was better than programmed. Thus the overall deficit excluding grants at RWF170.7 billion was lower than the RWF 181.3 billion programmed. Likewise the overall deficit including grants at RWF 1.6 billion was about RWF 8 billion lower than the program estimate of RWF 9.5 billion.

Of particular importance is the domestic fiscal deficit. This shows the extent of the injection of liquidity from fiscal performance (fiscal impulse) into the economy and has implications for monetary developments and inflation. Here again because of the better revenue performance, the outturn at RWF 70.6 billion was about RWF 9 billion lower than programmed.

Despite the lower monetary injection than programmed from fiscal operations, the conduct of monetary policy proved difficult owing to the additional liquidity injection of about RWF 31.2 billion representing the increase in private sector credit from the Banks in 2006. Because the sale of foreign exchange as an instrument for sterilizing excess liquidity has its limitations (preventing unwarranted appreciation of the franc) BNR resorted to an increased use of Treasury bills (both BNR and GOR bills) for the sterilization exercise. As a result domestic interest payments were slightly higher than programmed as mentioned above. These actions of BNR however led to the monetary targets being achieved in 2006.
A detailed discussion on monetary developments will be presented in a separate document.

IV.BUDGET IMPLEMENTATION CHALLENGES FROM 2006 FOR 2007

As mentioned above the implementation of the 2006 budget was mixed. On the one hand there was an excess in revenue collections partly attributed to the accrual of some "one off" revenue and partly due to the excellent performance of PAYE and VAT. On the other hand there were also expenditure pressures during the year. The challenge for 2007 therefore is whether the good revenue performance can be maintained and expenditure pressures can be contained during the year.

Another challenge is posed by the decentralization policy. About RWF 65.5 billion is expected to be disbursed to the districts in 2007 compared to RWF35 billion in 2006. Receiving accurate and timely data on spending from the districts to enable the consolidated budget reports to be produced on time also poses a challenge. It is hoped that the required machinery for data collection has been put in place at the district level and in MINALOG.

There is also the need to ensure the existence of adequate implementation capacity in the districts such that funds transferred from OTR's account will be promptly used and not accrue in bank balances. If this happens , not only will the funds provide excess liquidity to the banks to be used in purchasing treasury bills (BNR and GOR) and earn interest paid with budgetary funds, but they also become a source of discrepancy between the monetary and fiscal accounts. The provisional budget implementation data for 2006 shows a discrepancy of about RWF 7 billion between the monetary and fiscal data. This is partly attributed to transactions regarding these transfers to the districts. Reconciliation of the data is on-going and will be finalized at the beginning of February 2007 when the monetary survey is available. Ensuring that these discrepancies emanating from the decentralization policy remains small poses a further challenge.

Mention has been made above about the linkage of fiscal performance through the size of the domestic deficit to the conduct of monetary policy. In the revised 2007fiscal projections, the deficit has been programmed at RWF 124.7 billion, about RWF 54 billion higher than the outturn of RWF 70 billion in 2006. Finding the appropriate policy mix between the sale of foreign exchange without triggering an excessive appreciation of the currency and the sale of Treasury bills without "crowding out" the private sector from obtaining adequate funds for investment and increase domestic debt presents a huge challenge for 2007. Constant and intensive collaboration between MINECOFIN and BNR is required.

V. CONCLUSION

Despite the challenges in 2006, budget implementation was satisfactory. All the quantitative budget performance criteria were met. This was due to diligent monitoring of implementation. It is expected that this will continue in 2007.