AFRICAN DEVELOPMENT BANK GROUP
GROUPE DE LA BANQUE AFRICAINE DE DÉVELOPPEMENT

COUNTRY FOCUS REPORT 2024

RWANDA

Driving Rwanda's Transformation:
The Reform of the Global Financial Architecture

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ADB	African Development Bank
ADF	African Development Fund
AEO	African Economic Outlook
AFDB	African Development Bank
BaU	Business-as-Usual
BNR	National Bank of Rwanda
BRD	Development Bank of Rwanda
CAR	Capital Adequacy Ratio
CBR	Central Bank Policy Rate
CFR	The Country Focus Report
COVID-19	Coronavirus Disease 2019
CPIA	Country Policy and Institutional Assessment
CPI	Corruption Perception Index
CSPs	Country Strategy Papers
DRM	Domestic Resource Mobilization
DSA	Debt Sustainability Analysis
EAC	East African Community
EDPRS-1	Economic Development and Poverty Reduction Strategy
FDI	Foreign Direct Investments
GDP	Gross Domestic Product
GGCRS	Green Growth and Climate Resiliency Strategy
GHG	Greenhouse Gas
HCI	Human Capital Index
HIPC	Heavily Indebted Poor Countries
IDA	International Development Association
IDAL	International Debt Architecture and Liquidity
IFAD	International Fund for Agricultural Development
IFIs	International Financial Institutions
IIAG	Mo Ibrahim Index of African Governance
INGOs	International Nongovernmental Organizations
KfW	Kreditanstalt für Wiederaufbau (in English, Credit Institute for Reconstruction)
MDBs.	Multinational Development Banks
MDGs	Millennium Development Goals
MDRI	Multilateral Debt Relief Initiative Debt Relief
MICE	Meetings Incentives Conferences and Events
MTDMS	Medium-Term Debt Management Strategy

MTDS	Medium-Term Debt Strategy
MTRS	Medium-Term Revenue Strategy
NDC	Nationally Determined Contribution
NDGAIN	Notre Dame-Global Adaptation Index
NPL	Non-Performing Loans
NST	National Strategy for Transformation
PCG	Partial Credit Guarantee
PCI	Per capita Income
PEFA	Public Expenditure and Financial Accountability
PPF	Project Preparatory Facility
PPPs	Public-Private Partnerships
PRSP-2	Pioneering Poverty Reduction Strategy
RBF	Results-Based Financing
R&D	Research and Development
RII	Regional Integration Index
RPF	Rwanda Patriotic Front
RWF	Rwanda Franc
SDRs	Special Drawing Rights
SLB	Sustainability-Linked Bond
STEM	Science, Technology, Engineering, and Mathematics
TFP	Total Factor Productivity
ToT	Terms of Trade
TVET	Technical and Vocational Education and Training
UNFCCC	United Nations Framework Convention on Climate Change
COP28	United Nations Climate Change Conference
VAT	Value Added Tax

EXECUTIVE SUMMARY

Rwanda's economy continues to show remarkable resilience with a real GDP growth rate of 8.2% in 2022 and 2023, driven by expansion in the services and industrial sectors, supported by public investment and post-COVID fiscal stimulus. The economic outlook remains positive, with projected growth of 6.5% in 2024, and 6.8% in 2025. Inflation peaked at 14.3 percent in 2023 but fell to 4.2% by March 2024 before rising slightly to 5.8% in May 2024, due to tight monetary policy, and stabilized supply chains. The Central Bank raised the policy rate from 6% in August 2022 to 7.5% in August 2023, later reducing it to 6.5% in May 2024 to support growth. The Rwandan Franc (RWF) was weakened, due to reduced aid flows and a persistent trade deficit. Fiscal policy focused on sustainability, with a strategy to cap public debt at 65 percent of GDP by 2031.Total public debt as a share of GDP rose from 71 percent in December 2022 to 73 percent in December 2023. The current account deficit widened in 2023, due to a high trade deficit, but tourism receipts, remittances, and FDI helped finance it. The financial sector remained resilient, with significant asset growth driven by banking and microfinance. Vigilant oversight of financial stability risks, particularly large exposures and rapid credit growth is crucial. Rwanda must prioritize macroeconomic stability, and structural reforms to maintain and enhance its economic resilience.

Rwanda's vision 2035 has set stretching ambition to promote manufacturing and services economic model to become an upper middle-income country with a Per capita Income (PCI) of USD4035. However, the desired human, physical capital and technological investments required to accelerate this process through structural transformation seem to have stalled. The pace of aggregate productivity gain is below the average labor productivity growth for countries that have undergone systematic structural change in developing Asia. Agriculture has experienced low productivity gains but has the potential to increase aggregate productivity, and inclusive growth if appropriate investments in value-addition, and commercial farming are made. The analysis also reveals that Rwanda has adequately addressed most of the regulatory and institutional barriers to growth through sustained reforms and has the political will to drive change. However, several barriers including limited skills and technology, demographic pressures, limited land size and infrastructure deficits, and decoupling effects in sector linkages constrain the pace of productivity gains to accelerate structural transformation.

Rwanda's structural transformation requires significant investments in physical infrastructure, human capital, climate action, and productivity-enhancing technology. However, low domestic resource mobilization capacity, and limited access to external funds under the current global financial system pose major challenges. Reforming this system is crucial to secure concessional resources, increase climate finance and private capital, and strengthen domestic financial markets for accelerated economic transformation.

Rwanda has been a leading advocate for global financial reforms, particularly through the G20 Compact. Going Forward, Rwanda's engagement in advocacy for reforms should prioritize securing more concessional financing, especially climate finance, and addressing excessive debt to ensure fiscal sustainability. Greater regional coordination is needed to amplify the African voice in negotiation with richer countries and ensuring a fair and transparent global financial system for all.

INTRODUCTION

Located in East Africa, Rwanda is a landlocked country with a population of 13.8 million (Census 2022), and an area of 26,338 square kilometers. Emerging from the shadows of the 1994 Genocide against the Tutsi, Rwanda has maintained peace and political stability while achieving significant economic progress. Since 1995, the socio-economic turnaround has resulted into a rise in PCI from USD146 in 1995 to USD966 in 2022, and a substantial 22 years increase in life expectancy from 45 to 67 years of age during the same period. Rwanda's socio-economic renaissance has been guided by the ambition to transform into a lower-middle-income nation expressed in Vision 2050, with a PCI of USD 4,035 by 2035.

Despite its small size, Rwanda has established itself as a champion for security stabilization in Darfur, Central African Republic, and Mozambique as part of its Pan-African agenda and stands out among the highest UN peacekeeping contributing force in the world. The political climate currently remains peaceful with presidential and parliamentary elections scheduled to take place on 15 July 2024. The ruling Rwanda Patriotic Front (RPF) party, led by President Paul Kagame, is widely expected to win the elections, ensuring policy continuity in the country's development path.

Rwanda has been at the forefront of negotiations for global international financial architecture reform, particularly through the G-20 compact, aligning well with the thematic focus of the African Economic Outlook (AEO) report for 2024, dubbed as "Accelerating Structural Transformation and the Reform of the Global Financial Architecture." This CFR aims to domesticate the continental 2024 AEO to the Rwanda's context.

This report is structured into four chapters including this introduction. Following the introductory chapter, chapter two covers recent macroeconomic performance and outlook; chapter three reviews the patterns of Rwanda's economic transformation progress between 1980 and 2022, while chapter four discusses financing structural transformation, and reforming the global financial architecture.

1 MACROECONOMIC PERFORMANCE AND OUTLOOK

KEY MESSAGES

- Rwanda's economy demonstrated resilience with a real Gross Domestic Product (GDP) growth of 8.2% in 2022 and 2023, driven by expansions in the services and industrial sector, fueled by substantial public investments.

- The economic outlook is positive with real GDP projected to decline to 6.5% in 2024 and 6.8% in 2025, due to repeated climate shocks impacting rain-fed agriculture, and ongoing fiscal consolidation efforts.

- After two years of elevated prices, with headline inflation peaking at 14.3 percent in 2023, inflation decelerated rapidly since January 2024. By March 2024, headline inflation reached 4.2%, due to a combination of tight monetary policy and stabilized supply chains, and recovery in food production.

- Rwanda's public debt increased from 66.7 percent of GDP in 2022 to 73 percent in 2023, requiring policy measures to ensure fiscal sustainability. These measures include growth-friendly fiscal consolidation to achieve a debt ratio of 65 percent of GDP, and productivity enhancements in agriculture to prevent inflation, and support structural transformation.

1.1 Growth Performance

Real GDP growth stabilized at 8.2% in 2022 and 2023, supported by expansion in the services and industrial sectors, which make up 66 percent of the GDP and grew by 12 percent and 10 percent, respectively. Growth also benefited from substantial public investment in infrastructure and post COVID fiscal stimulus. Although agriculture still comprises a sizable 27 percent of GDP, its growth was modest at 2%, due to vulnerability to climate change shocks. The service sector's growth was fueled by an increase in tourism services, thanks to the successful implementation of the Meetings, Incentives, Conferences, and Events (MICE) strategy.[1] Meanwhile, the industrial sector's growth benefited from a construction boom spurred by substantial investments in sports, and aviation infrastructure projects. Private consumption and public investment primarily drove the demand side of GDP growth. Consequently, PCI grew by 5.9%, rising in absolute value from USD966 in 2022 to USD994 in 2023.

Rwanda's economy showed remarkable resilience against climate related shocks with a real GDP growth rate of 8.2% in 2022 and 2023. Outlook remains positive but real GDP growth is expected to moderate to 6.5% in 2024 due to the ongoing fiscal consolidation and possible continued climate shocks to the agriculture sector output.

1.2 Other Recent Macroeconomic Performance

1.2.1 Monetary Policy – Inflation – Exchange Rate

Headline inflation increased from 13.9 percent in 2022 to 14.3 percent in 2023, reflecting high cost of imported goods, and low domestic food production. The National Bank of Rwanda (BNR) increased the policy rate from 6% in August 2022 to 7.5% in August 2023 to counter rising inflation but maintained the same rate in February 2024 as inflationary pressures reduced. Food prices also declined with improved season A harvests[2]. This contributed to a rapid decline in Headline inflation to 4.2% in March 2024 before rising to 5.8% in May 2024. Due to slow down in inflation, in May 2024, BNR has reduced the Central Bank Policy Rate (CBR) to 6.5%, to support growth amidst subdued inflation. The RWF weakened from 1036.23 RWF/1 USD in 2022 to RWF 1263.9 per 1 USD in 2024, due to a significant reduction in aid flows, a persistent structural trade deficit, and weak investor sentiments amidst the impact of the multiple shocks, and tight global financial conditions.

1.2.2 Fiscal Policy

Rwanda is implementing a fiscal consolidation strategy to ensure long-term fiscal sustainability. The 2023/24 budget focused on domestic revenue mobilization and rationalizing public spending to cap public debt at 65 percent of GDP by 2031, considered a safe level for fiscal stability.

Future reforms aim to broaden the tax base by streamlining tax holidays and expenditures, enhancing compliance, and reducing evasion. On the expenditure side, the government plans to manage public spending by cutting recurrent expenditures, reducing non-essential travel, and increasing virtual meetings to lower conference and workshop costs. The government aims to achieve this by setting expenditure ceilings for ministries to support strategic spending. Total expenditure as a share of GDP is expected to decrease from 28.6 percent in 2023 to 28.3 percent in 2024. The counter-cyclical fiscal consolidation improved the primary fiscal deficit ratio to GDP from 5.8% in 2022 to 5% in 2023, with a further reduction to 3.6% projected for 2024. Consequently, the fiscal deficit, including grants, decreased from 7.7% of GDP in 2022 to 7% in 2023. These patterns demonstrate the government's efforts to restore fiscal discipline after elevated spending during the 2021 COVID-19 downturn.

[1] MINECOFIN 2024 budget framework paper.
[2] The harvesting season for agriculture in Rwanda.

1.2.3 Public Debt

Rwanda's total public debt as a percentage of GDP increased from 66.7 percent in December 2022 to 73 percent 2023. External debt, which is 53.7 percent of GDP, primarily consists of concessional debt from multilateral development agencies (75.6 percent). The government's quarterly issuance of domestic debt, which started in 2014, has boosted the capital market, raising domestic debt to 18.2 percent of GDP in 2023. Despite increased debt, public debt indicators remain sustainable. External and overall debt distress risks have risen from low to moderate largely, due to the impact of COVID-19, but liquidity and solvency indicators are well below critical thresholds. The present value of external debt to GDP is 33.6 percent in 2023, well below the 55 percent threshold by 2032. High concessional debt keeps overall debt affordable, with an average maturity of 14.8 years, exceeding the 10-year benchmark. Interest payments rose from 1.4% of GDP in 2020 to 2% in 2023 but remain low, due to the predominance of concessional loans. Rwanda faces foreign exchange risk with 84.6 percent of total debt in foreign currency. Moody's upgraded Rwanda's credit rating from B negative in 2022 to B positive in September 2023, affirming the country's creditworthiness and ability to meet financial obligations. To ensure long-term sustainability, the government has embarked on a growth-friendly fiscal consolidation strategy to anchor debt at 65 percent of GDP by 2030. This strategy emphasizes maximizing concessional loans, careful project selection, sparing use of commercial loans for profitable projects, and lengthening maturity profiles.

Table 1: Recent Macroeconomics and Social Indicators 2019-2025

Macroeconomic Indicators	2019	2020	2021	2022	2023(e)	2024(p)	2025(p)
Real GDP Growth	9.5	-3.4	10.9	8.2	8.2	6.5	6.8
Inflation	2.4	7.7	0.8	13.9	14.3	7.0	5.2
Overall Fiscal Balance, Including Grants (% GDP) *	-6.1	-8.0	-8.1	-7.7	-7.0	-6.4	-5.9
Primary Balance (% GDP) *	-4.9	-6.5	-6.3	-5.8	-5.0	-4.1	-3.6
Current Account (% GDP)	-11.9	-12.4	-10.7	-10.3	-11.1	-10.9	-10.7
GDP per Capita (USD)	806.8	774.7	822.1	966.0	994.2	995.3	1,039.1
Total Population (Millions)	12.8	13.1	13.5	13.8	14.1		
Life Expectancy at Birth (Years)	66.4	66.8	66.1	67.1	67.4		

Source: Data from domestic authorities and AfDB statistics department, April 2024; estimates(e) and predictions(p) based on authors calculations.

1.2.4 External Position

The current account deficit, including official transfers, as a percentage of GDP, widened from 10.3 percent in 2022 to 11.1 percent in 2023. This increase was driven by increased trade deficit, due to faster import outlays. Traditional exports like coffee, tea, and non-gold minerals underperformed, while food imports and construction goods for infrastructure projects in the sports, and aviation sectors increased. Consequently, the trade deficit rose from 14.9 percent of GDP in 2022 to 16.8 percent of GDP in

Box 1 : Rwanda, Successful Repayment of 2013 Eurobond

Rwanda's successful retirement of its USD400 million Eurobond acquired in 2013 exemplifies effective debt management strategy. The authorities capitalized on favorable market conditions in 2021, after the COVID-19 economic downturn, by issuing a second Eurobond. This raised USD620 million with a 10-year maturity at a 5.5% yield. The proceeds were used to buy back part of the retiring bond, reducing debt stock, and interest payments. Additionally, the funds were used to repay a USD120 million expensive debt from Afrexim Bank, build the Kigali Convention Center, and acquire new aircraft for RwandAir. The remaining funds supported priority projects in energy, health, and agriculture. This strategic timing and optimal debt redemption choices underline Rwanda's proactive approach to maintaining sustainable public debt.

Source: Extracts from the Medium-Term Debt Management Strategy (MTDMS) 2024/5-2026/7

2023. Tourism receipts which increased from USD400 million in 2022 to USD564 million in 2023, equivalent to 34 percent of the financing gap, provided the primary source of financing for the current account deficit. The net external financial flows to Rwanda increased and contributed to an overall balance of payment surplus. Remittances rose from USD 461.2 million in 2022 to USD504 million in 2023. Foreign Direct Investments (FDI) also increased, from USD305 million to USD459.2 million. Gross reserves were USD118.8 million in 2023, compared to USD139.2 million in 2022, equivalent to 4.5 months of imports.

1.2.5 The Financial Sector

Rwanda's financial system consists of 15 commercial banks, 13 pension schemes, 457 microfinance institutions, and 15 insurance companies. Banks dominate, holding 67.4 percent of sector assets. According to the BNR annual report for 2023; in 2023, the sector saw significant growth: banking assets increased by 18 percent from FRW 8,145 billion in June 2022 to FRW 9,635 billion, due to retained earnings, and deposit growth. The pension sector grew by 16.2 percent with higher contributions and investment income, while the insurance sector expanded by 17.2 percent through retained earnings, and capital injections. The microfinance sector also grew. By June 2023, banks had a total Capital Adequacy Ratio (CAR) of 21.1 percent, surpassing the 15 percent regulatory minimum. Capital adequacy for microfinance institutions, insurance companies, and pension funds also exceeded requirements. Asset quality improved as banks reduced their Non-Performing Loans (NPLs) ratio from 4.3% to 3.6%, and microfinance institutions lowered theirs from 4.7% to 3.7%. This improvement stemmed from NPL write-offs, economic growth, and better credit monitoring. The BNR's tests on banks' largest loan exposures revealed significant concentrations, especially in sectors like construction, manufacturing, transportation, trade, and energy. These large exposures require ongoing monitoring to prevent the recurrence of large NPLs. The 2023 Finiscope survey indicates that 93 percent of Rwandan adults are financially included through formal, and informal channels. The BNR continues to expand access to financial services, promote digital solutions, foster fintech innovation, and encourage collaboration among financial institutions to better serve underserved population.

1.2.6 Poverty and Social Indicators

As of 2022, Rwanda's population reached 13.2 million, growing annually by 2.3%.

The average household comprises four people. Life expectancy rose to 67.4 years in 2023, due to healthcare improvements, and enhanced living standards. Electricity reaches 61 percent of the population, and 65 percent have access to basic drinking water. Educational attainment remains low, with only 22.3 percent of eligible students attending secondary school, and 3.3% pursuing university education. Poverty rates have declined significantly, from 60 percent in 2000 to 38.7 percent in 2017; however, the COVID-19 pandemic reversed some gains, pushing over 600,000 people back into poverty between 2020-2021. Income inequality, measured by the Gini Coefficient, has slightly improved, moving from 0.52 in 2005 to 0.46 in 2019. As of August 2023, Rwanda's unemployment rate was estimated at 16.8 percent, down from 23.5 percent in May 2022, thanks to efforts to boost economic growth, and job creation. However, disparities remain, with unemployment rates higher among women (20.1 percent) compared to men (13.9 percent), and in rural (17.1 percent) versus urban areas (16.3 percent). Youth unemployment, affecting those aged 16 to 30, is particularly high at 21.5 percent, underscoring the challenge of harnessing on Rwanda's demographic potential.

1.3 Macroeconomic Outlook and Risks

1.3.1 Outlook

The economic outlook is positive but real GDP growth is projected to slow down to 6.5% in 2024, and 6.8% in 2025 respectively, due to contractionary effects of the ongoing fiscal consolidation and external shocks to the agriculture sector. Headline inflation is expected to decrease and average 7.0% in 2024 and 5.2% in 2025, reflecting stabilized supply chains, and sustained tight monetary policy. The fiscal deficit as a ratio of GDP is projected to decline to 6.4% in 2024 and 5.9% in 2025, supported by fiscal consolidation. The current account deficit is anticipated to reduce from 10.9 percent of GDP in 2024 to 10.7 percent in 2025, due to improvements in the Terms of Trade (ToT), with reserves forecasted to rise to 4 months of imports in 2024, supported by inflows from IFIs.

1.3.2 Main Downside Risks

Downside, risks include climate variability threatening Rwanda's agriculture due to its reliance on rainfall. Insecurity spillovers from the conflict in the Democratic Republic of Congo (DRC) could harm the economic

Box 2 : Impact of Tighter International Financial Market Conditions (Transmission Mechanisms).

Since 2013, Rwanda experienced aid decline and public debt to offset aid short fall has nearly doubled to 73 percent of GDP in 2023 to support development spending. Geopolitical fragmentation, tightening global financial conditions, and consecutive weak agricultural seasons have pressured international reserves. Interest rate hikes in advanced economies have weakened the local currency, increasing inflation. The May 2023 floods and required reconstruction efforts further strained the fiscal space needed for structural transformation. Rwanda's tax potential remains substantial and comparable to other East African Community (EAC) countries. The overall tax gap is estimated at 5% of GDP. Efforts to increase the tax ratio from the current 15 percent of GDP to 20 percent by 2030 require a phased approach to ensure growth-friendly fiscal consolidation. Rwanda needs improved access to external finance to mitigate impacts, unlock productivity growth, and broaden the tax base. However, access is constrained by the global financial architecture, limited power in the governance structure of International Financial Institutions (IFIs), limited borrowing headroom with Multinational Development Banks (MDBs), and unfavorable credit ratings by MDBs, and private credit rating agencies. Structural transformation supporting growth base diversification is critical for Rwanda to ensure rapid, inclusive, and sustainable growth, and to build resilience to future shocks.

outlook. Slower growth in trading partners and weakened tourism may reduce export revenues. Uncertainty over GBP 50 million in UK grants under the Migration and Economic Development Partnership for FY 2024/25 and 2025/26 could create budget pressures and reduce foreign exchange inflows if not secured.

1.4 Conclusion and Policy Recommendations

Despite climate and external shocks, Rwanda's economy showed resilience with real GDP growth of 8.2% in 2022 and 2023. However, declining aid, a structural current account deficit, and increased financing needs to support growth and climate mitigation have led to substantial external borrowing, raising public debt to 73 percent of GDP.

A mix of short-, medium-, and long-term policies are needed to address Rwanda's macroeconomic imbalances:

In the short-term, monetary policies should be proactive and data-driven to achieve a stable inflation target of 5-8%. The currency should be allowed to adjust to economic fundamentals to prevent losses in foreign exchange reserves and create head room to absorb shocks. The BNR should maintain oversight of the financial system to safeguard stability and prevent large exposures to NPLs.

In the medium-term, the government should pursue growth-friendly fiscal consolidation to reduce the debt-to-GDP ratio to 65 percent by 2030, strengthening public finance and debt management to reduce unproductive expenditure and promote fiscal sustainability. Structural policies should focus on increasing agricultural productivity, particularly targeting productivity enhancements in smallholder famers to increase production and mitigate against climate induced food inflation. This includes making investments in irrigation infrastructure, improved food production technologies, and the growth of input markets.

TAKING STOCK OF RWANDA'S STRUCTURAL TRANSFORMATION PROGRESS

2

KEY MESSAGES

- Rwanda's Vision 2035 aims for upper middle-income status by prioritizing manufacturing, and services, but, as detailed in the analysis below, structural transformation is stalling, due to insufficient investments in human capital, technology, and infrastructure.
- While institutional and political reforms played commendable roles in Rwanda's gradual structural transformation from 2000-2019, persistent barriers such as low agricultural productivity, technological limitations, demographic pressures, and infrastructure deficits continue to hinder progress.
- To sustain economic growth and achieve middle-income status, targeted interventions in addressing skills deficits and physical infrastructure are crucial to enhance productivity, innovation, and harness the demographic dividend of the youth bulge.
- To achieve structural transformation through investment in infrastructure and human capital, the government will have to weigh investment financing options that generate optimal results. A mix of borrowing, and domestic revenue mobilization during specific periods will have to be considered.

2.1 Historical Progress in Economic Performance 1980-2022

Over the past four decades, Rwanda achieved an average annual real GDP growth of 4.6%, above Africa's 2.8% average. This economic transition can be divided into two distinct phases. From 1980 to 1999, the economy stagnated, with growth, and PCI below the continental average, due to poor macroeconomic policies, debt crises, political patronage, state control of key sectors of the economy, and the impact of the 1994 Genocide against the Tutsi. Economic stagnation continued through 1995-1999 because the economy was pre-occupied with efforts to recover and stabilize, rebuild institutions, resettling displaced communities, and providing basic humanitarian aid. During this period, real GDP growth remained low at 2.2%, and below 3.3 for Africa.

Phase-2 which span 2000 to 2022 was characterized by growth acceleration. Between 2000 and 2009, real GDP grew by 8.3% annually above the continental average (4.7%), driven by post-war recovery efforts, increased aid, and significant debt relief. PCI rose by 5.9%, outpacing Africa's 2.2% average. In 2005, Rwanda received USD1.2 billion in HIPC/MDRI debt relief, reducing external debt, and allowing increased spending on social, and productive sectors. Limited global market connections shielded Rwanda from the 2008-2009 financial crisis, maintaining growth momentum until aid cuts in 2012 slowed the economy in 2013. Strategic investments and strong agricultural performance spurred recovery in 2014 and 2015, although global commodity price shocks in 2016 led to subdued growth in 2017.

Growth surged to 9.3% in 2019 due to strong domestic demand but contracted by 3.4% in 2020, due to the COVID-19 pandemic. However, real GDP growth rebounded to 10.4 percent in 2021, and stabilized at 8.2% in 2022, and 2023, supported by fiscal stimulus, and proactive health measures, including nationwide vaccination. This phase has also been marked with systematic articulation of the long-term vision for the country including the vision 2020 and later on, vision 2035 with specific targets to reduce poverty and achieve a middle-income status with a GDP PCI of over USD4,036. Macroeconomic stability has been a key feature of this economic transition. However, despite sustained robust growth, during this phase, structural transformation has been slow, limiting growth transmission into sustainable jobs, and steep decline in poverty.

During this period, the structure of the economy experienced minimal shifts from sectors of low productivity to sectors with high productivity. For example, from 2000-2022, agriculture sector as a ratio to GDP declined from 31 percent in 2000 to 25 percent in 2022 but remains the second largest sector of the economy and employing 62 percent of the labor force. During the same period, the industrial sector which has the potential to generate high productivity value and jobs changed

Table 2: Real GDP and Real Per Capita Income (PCI) Growth

		1980-89	1990-99	2000-09	2011-19	2020	2021	2022	AVG
Rwanda	GDP	2.4	2.2	8.3	7.2	-3.4	10.9	8.2	4.6
	PCI	-1.1	0.9	5.9	4.6	-5.7	8.3	5.7	2.1
Africa	GDP	2.7	3.3	4.7	4.0	-2.4	4.7	4.2	2.8
	PCI	-1.4	-0.3	2.2	0.6	-5.0	2.3	0.8	-0.3

Source: AEO 2024 data set PCI stands for per capita income.

slightly from 17 percent of the GDP to 21 percent. The services sector remains the largest sector of the economy having changed slightly from 44 percent in 2000 to 46 percent in 2022, with labor still trapped in low value service sector activities.

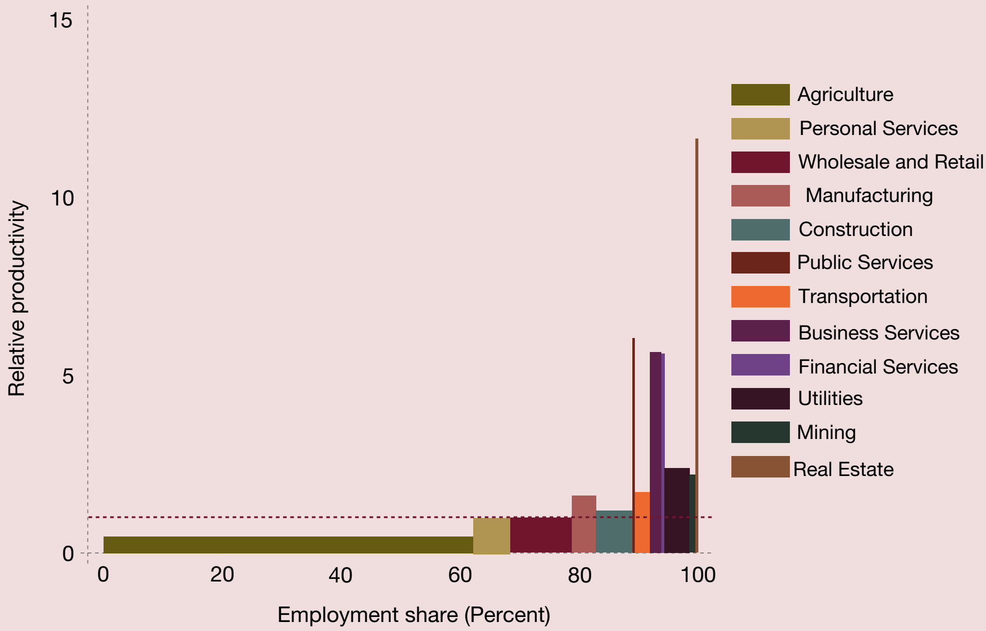
2.2 Rwanda's Structural Transformation: Drivers, Bottlenecks, Opportunities

2.2.1 The Role of Structural Transformation in Rwanda's Recent Growth

Structural transformation is largely understood as a process of relocating labor from low productivity activities (agriculture for example) to high productivity activities (manufacturing and formal services (structural change), improving productivity within sectors (e.g., from subsistence to high-value crops), and diversifying productive capabilities by increasing the types of goods and services produced, and focusing on exports. This process is required for sustainable economic transformation (Dani Rodrik 2011). The role of structural transformation in Rwanda's recent growth is analyzed following the methodology proposed by McMillan and Rodrick in figure 1 and is illustrated in Figures (2-3), capturing data of the labor productivity of 11 main sectors, with relative productivity on the vertical axis and employment share on the horizontal axis. Relative productivity is calculated as the ratio of each sector's labor productivity to the economy's average. The horizontal dashed red line represents the economy's weighted average productivity level. Rwanda is still at early stage of structural transformation with significant productivity gaps across sectors. The agriculture sector employs 62.3 percent of the labor force and has a relative productivity ratio (0.46), which is 54 percent less productive than the economy-wide average. In contrast, sectors such as real estate, mining, utilities, financial services, business services, construction, and manufacturing have productivity levels above the economy-wide average, but jointly employ less than 20 percent of the workforce. These sectoral employment patterns and productivity gaps imply that Rwanda is still categorized as a structurally underdeveloped economy.

Rwanda's structural transformation reveals significant labor productivity gaps, driven by shifts from low-value agriculture to low-productivity service sectors, limiting structural impact. The current growth model may be reaching its limits, underscoring the need for continued technological innovation and value addition in high-potential sectors.

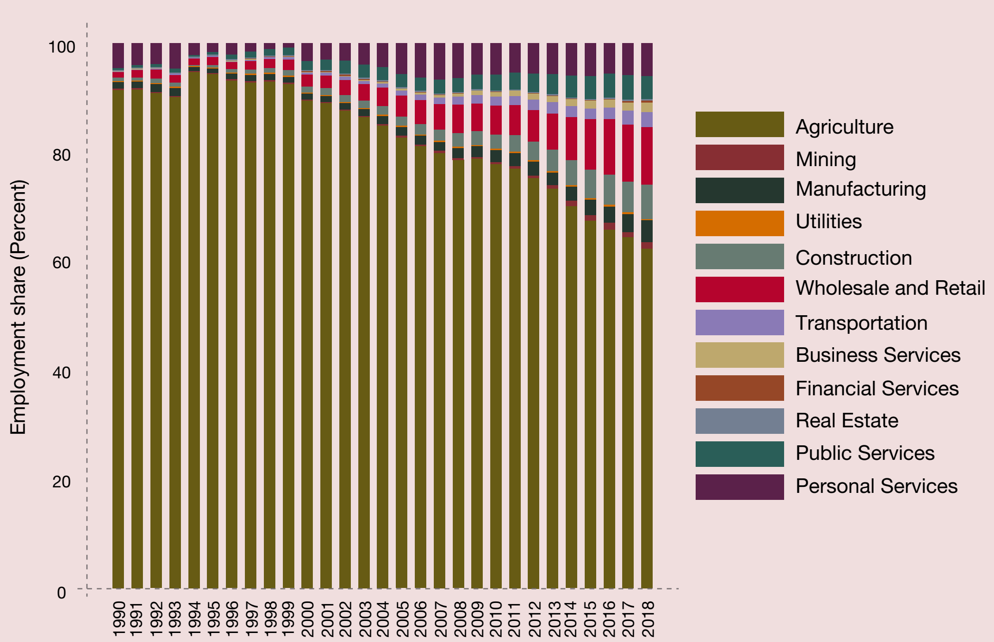
Figure 1: Relative Sectoral Productivity and Employment Shares in Rwanda, 2018



Source: Staff calculations using the Economic Transformation Database (Kruse et al. 2023).

Figure 2 shows changes in sectoral employment shares in Rwanda between 1990 and 2018. In this analysis, the employment shares of those engaged in agriculture decreased from 94 percent in 1995 to 62.3 percent in 2018. A sizeable number of those who transitioned out of agriculture shifted to wholesale, retail, and personal services whose relative productivity is slightly below the economy wide average. The employment shares of the manufacturing sector, traditionally associated with structural change, due to its high capacity for absorbing low-skilled workers, increased slightly by only 1.96% between 1990 and 2018, from 1.34% in 1990 to 3.97% in 2018. Tradable and relatively productive services sectors had a high relative labor productivity, above the economy wide average with business services having a relative productivity ratio of 2,4%, transport services (1.7%), and financial services (5.6%), but have low employment share of 4.1%, 2.7%, and 0.5% respectively. Construction sector has become the third most significant sector in the economy. The share of labor force in construction sector increased from 0.5% in 1990 to 6.2% in 2018, and its weighted relative productivity (1.2) is above the weighted economy wide average.

Figure 2: Sectoral Employment Shares in Rwanda 1990–2018



Source: Staff calculations using the Economic Transformation Database (Kruse et al. 2023).

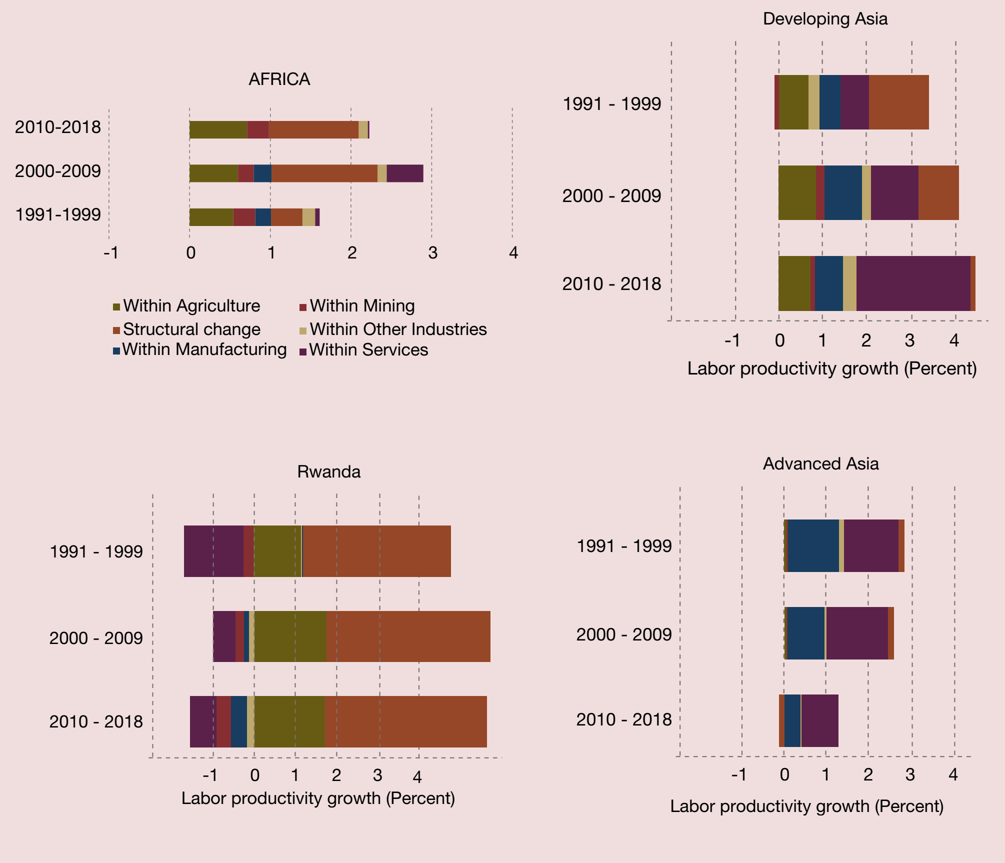
2.2.2 Unpacking Rwanda's Structural Transformation Through Labor Productivity Decomposition

Figure 3 further compares the patterns of structural transformation in Rwanda with those in Africa, and Asia. This comparison uses unweighted average relative productivity, calculated from the economic transformation database derived from African Economic Outlook (AEO 2024). Over the period from 1991 to 2018, Rwanda's economy-wide unweighted average labor productivity increased by 2.61% annually. This rate surpasses the African average of 1.96% (Mensah et al., 2022) but falls short of Developing Asia's average of 3.73%. In Rwanda, this 2.61% growth is split between intra-sector productivity (1%), and productivity gains from structural change (1. 6%). The productivity growth, due to structural change is explained by the declining share of employment in agriculture, from 95 percent at its peak in 1995 to 62.3 percent in 2018. This trend reflects a common pattern in low-income countries where early structural transformation is driven by surplus labor moving away from agriculture. Figure 3 reveals that Rwanda's experience aligns closely with that of other African nations.

From figure 3, it is noted that while developing Asia[3]s initial productivity growth was driven by labor shifting from agriculture to manufacturing and services, or (structural change) it later, particularly from 2010-2018, relied more on innovation within the service sector, due to technological advancements, and capital accumulation. This contrasts with Rwanda, where productivity growth has stalled, and it is still dependent on structural change, and modest productivity gains in agriculture.

The analysis of Rwanda's structural transformation through labor productivity decomposition provides the following insights on recent economic transformation: (i) Significant labor productivity gaps exist across sectors and activities, thus providing a scope for improving aggregate productivity from reallocation of labor; (ii) More than a half of Rwanda's labor productivity growth from 1990-2018 has been driven by structural change rather than within sector productivity and characterized by labor reallocating from low value agriculture to relatively low-productivity sectors in wholesale, and personal business. This type of sectoral reallocation has a limited impact on structural transformation because most workers are stuck in low productive sectors and cannot earn enough to exit poverty. (iii) Within agriculture, labor productivity growth was consistently positive across the three decades albeit below the economy

Figure 3: Structural Change in Rwanda Africa and Asia, 1991–2018



Source: Staff calculations using the Economic Transformation Database (Kruse et al. 2023).

[3]Developing Asia includes China, Indonesia, Malaysia, Thailand, Vietnam, Bangladesh, Cambodia, Vietnam, and Laos.

wide average labor productivity. This indicates a suppressed potential to raise further productivity growth in the sectors through technological innovation and value addition in agricultural value-chains, and commercialization. (iv) Rwanda's current growth model may be reaching its limits, with gradual increases within-sector productivity and diminishing effects of structural change. This implies that the initial easy gains from adopting new technologies and improving efficiencies have been exhausted and indicates the need to shift the growth strategy and focus on enhancing productivity on high potential sectors.

2.2.3 Policy Shifts that Explain the Patterns of Structural Transformation in Rwanda 1990-2022

The patterns of Rwanda's structural transformation are the result of four main policy shifts. Between 2002-2025, the Pioneering Poverty Reduction Strategy (PRSP-2) aimed to address post-war reconstruction, rebuild institutions for economic, political, and social governance, and achieve the Millennium Development Goals (MDGs). This phase, largely funded by external aid, contributed to an average real GDP growth of 8%, and a decline in poverty incidence from 60 percent in 2000 to 57 percent in 2005, along with significant improvements in health and education outcomes. However, it did not adequately address the main structural constraints to productivity growth in agriculture, industry, and services, resulting in only a marginal decline in poverty, and raising doubts about the strategy's ability to deliver the MDGs.

This phase was followed by the Economic Development and Poverty Reduction Strategy (EDPRS-1) for 2008-2012 which was designed to support inclusive growth and address productivity barriers to catalyze job creation and accelerate poverty reduction. EDPRS-1 was implemented through three flagship programs: (i) Sustainable Growth for Jobs and Exports, (ii) Vision 2020 Umurenge (integrated rural development), and (iii) Good Governance. The first two pillars prioritized accelerating growth for exports, and reallocating labor to productive activities to promote inclusive growth and eliminate extreme poverty and inequality through targeted social protection programs. The governance pillar aimed to address coordination failures in service delivery through governance reforms at central and local levels, and increased use of performance contracts to strengthen accountability for results. This phase is considered to be the most successful strategy which contributed to productivity growth. Economic growth averaged 8.2% over the period, while poverty reduced from 56.7 percent to 44.9 percent, allowing more than 1,000,000 Rwandans to be lifted out of poverty in less than five years. Income inequality also reduced to 0.49 in 2011 below the level of 2001[4].

Between 2013 and 2018, the government continued with the implementation of the EDPRS II, aiming to consolidate the gains made in EDPRS-1 and achieve the vision 2020 targets of becoming a lower, middle income country with a per capita GDP of USD1240 by accelerating economic growth to (11.5 percent average), reducing poverty to below 30 percent, and restructuring the economy towards services and industry. During this phase, several strategic investments in energy, transportation (road, and air services), agriculture, ICT – fiber optic network, Tourism and MICE strategy, and enabling environmental reforms, skills development, especially Technical and Vocational Education and Training (TVET), higher education, and export diversification were initiated, however, real GDP growth averaged 5.9 %, short of the target (11.5 percent). This is explained by low resource flows as aid declined[5]

[4]EDPR2-2013
[5]Aid flows declined from 11.3 percent of GDP in 2000 to 4.9% in 2017.

, persistent drought which affected agricultural output, and global commodity price shock which reduced receipts from the major export commodities in 2016 and 2017, weak productivity growth in service sector projects as most of the large upfront strategic investments had not started generating returns. Agriculture averaged 4.1% compared to (8.5% targeted), industry averaged 6.5% compared to (14 percent targeted), and services grew by 7.5% compared to the target 13.5 percent[6].

In the context of persistent low productivity achievements and the evolving development context, the government has developed a new vision 2035 with a long-term horizon to 2050 to address the pervasive barriers to productivity growth. This vision is anchored on five interrelated goals aimed to reduce the infrastructure deficits and skills deficits which deprive the economy of the innovative capacity, and competitiveness required to scale up productivity gains in all the sectors of the economy. These goals include investment (i) investing in human development, (ii) improving competitiveness and integration (iii) agriculture for wealth creation (iv) urbanization and agglomeration, and accountable and capable state institutions. The ultimate goal is to achieve an accelerated real GDP growth of 12 percent per annum to 2035, generating an average middle PCI of USD4,036.

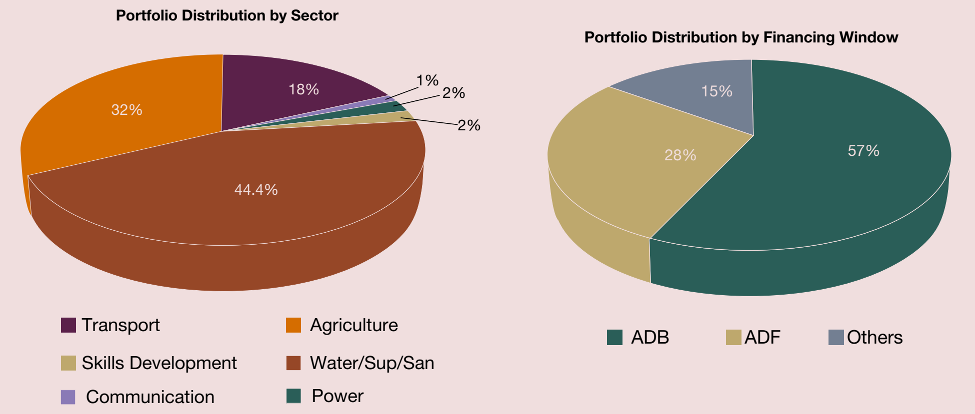
2.2.4 The Role of the African Development Bank in Rwanda's Transformation

The Bank has been an active lender to the government of Rwanda since 1974, but its operations to support transformation has been scaled up since 2006, when it opened its the country office in Kigali. The Bank's total active portfolio currently stands at a total commitment of UA 1.7 billion in 2024.

The Bank's recent three five-year Country Strategy Papers (CSPs) between 2012 and 2025 targeted infrastructure development, and creating an enabling environment for the private sector, with an emphasis on skills development[7]. The strategic alignment of the Bank's lending program is informed by the need to address the high cost of infrastructure in energy, transport, water sector, and skills deficits which are considered the most binding constraints to Rwanda's transformation. As shown in figure 4, 94.2 percent of the total portfolio is committed to infrastructure, while 2% goes to skills development, aligning well the Bank's HIGH-5[8] priorities. Rwanda has been a key beneficiary of the highly concessional loans provided under the African Development Fund (ADF) lending window which supported the country to maintain a low debt distress. The significant increase in the volume of loans to Rwanda also benefited from the 2014 revision of the credit policy which allowed low income and blend countries with a good track record of debt sustainability and macroeconomic management to access less concessional loans under the African Development Bank (ADB) window. Rwanda was proactive in accessing this window to increase lending for transformative projects in the water and energy sectors, including pioneering innovative instruments introduced by the Bank. Projects benefiting from these initiatives include: (i) Mobilizing UA 205 million to finance the scaling up of an energy Access Project under the Results-Based Financing (RBF) instrument, and (ii) Leveraging its ADF headroom as a Partial Credit Guarantee (PCG) to secure better-priced resources from international financial markets, increasing lending fourfold from its ADF allocation to USD200 million for sustainable transformational projects in the 2024/25 budget.

[6]National Strategy for Transformation (NST-1 report 2017-2024).
[7]CSP evaluation report 2012-2021 &CSP 2022-2025.
[8]The HIGH -5 refers to the AfDB five priority areas for transforming Africa and include: Light and power Africa, Feed Africa, Industrialize Africa, integrate Africa, and improve the quality of life for Africans.

Figure 4: Rwanda Portfolio Snapshot - May 2024



2.3 Drivers and, Bottlenecks, and Opportunities to Accelerate Structural Transformation in Rwanda.

2.3.1 Key Bottlenecks to Fast-Paced Structural Transformation in Rwanda

Human capital development: Rwanda's ambition to accelerate growth in manufacturing and services faces significant human capital challenges. According to the World Bank's Human Capital Index (HCI), Rwanda scores 0.38, below the Sub-Saharan average of 0.4 but higher than the low-income countries' average of 0.37. This means a child born in Rwanda today will achieve only 38 percent of their potential human capital by age 18, compared to 45 percent in Ghana, and 55 percent in Kenya. This low HCI score results from insufficient investments in health, nutrition, and education, leading to high stunting rates (33 percent), and poor learning outcomes. These issues limit future productivity and earning potential. The AfDB's 2023 report estimates Rwanda needs to increase its per capita spending on health and education by 2.7 times, reaching USD129 per capita, to achieve the median HCI for low-middle-income countries by 2034.

Physical infrastructure: Addressing infrastructure deficits has been a key focus of Vision 2020 and remains a priority in Vision 2035 to improve Rwanda's competitiveness, attract investments, and create jobs. Rwanda has made commendable progress in increasing access to basic infrastructure. However, the current infrastructure stock is still inadequate, and costs for end users are higher than in neighboring countries, reducing Rwanda's ability to attract foreign investments, diversify the economy, and create jobs. For example, Rwanda increased electricity generation from 108 MW in 2012 to 354 MW in 2024, raising the population's access from 16.8 percent in 2012 to 61 percent in 2022. However, electricity costs remain the highest in the region, with a tariff of USD0.22 per kWh, double that of other EAC countries, which range between USD0.10-0.12 per kWh. These high costs constrain the local manufacturing sector, reducing the capacity of local brands to compete on price, and build market share. Additionally, high generation costs make electricity tariffs unaffordable for many poor people. Transportation costs are also high, due to Rwanda's landlocked position. Moving a container from Mombasa to Kigali costs about 40 percent of the container's value, compared to 12 percent for Kenya, and 36 percent for Uganda. Inefficient and costly logistics infrastructure limit Rwanda's ability to export goods, especially perishables that require fast market access, such as fresh fruit, and flowers. Persistent non-tariff barriers in the region further compound these costs. Although access to water supply and sanitation increased from 56 percent in 2012 to 65 percent in 2022, inadequate access to water remains a significant constraint to rapid urbanization, and the growth of industrial and special economic zones.

Demographic challenges. With an estimated population of over 13.2 million people in 2022 and a surface area of 26,338 km², Rwanda is the most densely populated country in Africa, with approximately 503 inhabitants per km². Although the fertility rate has declined from 4.8 children per woman in 2002 to 3.6 in 2022, the working-age population (15-59) is projected to increase from 7.88 million (58 percent) in 2022 to 13.2 million (63 percent) by 2050. While a young population could be an asset, the current rate of job creation and the low quality of the education system hinder the transition from low-productivity agriculture to services and manufacturing, delaying structural transformation and contributing to a 23.5 percent unemployment rate. Rwanda needs to build on its success in reducing the fertility rate by increasing investments in health and education to harness the opportunities presented by its young working-age population.

There is a suppressed potential in Rwanda's agriculture to support structural transformation to take place and consequently, 62 percent of the workforce remains trapped in low productivity agriculture. This stagnation is due to land scarcity, high population density, challenging topography, limited mechanization and irrigation, inadequate skills, lack of access to finance, and high post-harvest losses. Accelerated structural transformation will occur only if the potential in agriculture is unlocked through commercial farming and establishing stronger backward and forward linkages with other sectors, allowing labor to relocate to other sectors of the economy.

Climate change as constraint to economic transformation: Ranked as the seventh most vulnerable country to climate change, Rwanda relies heavily on rain-fed agriculture, making it prone to floods, landslides, and droughts. These events threaten food security and livelihoods, especially for the poorest communities. An IMF report[9] revealed that 11 out of 19 surveyed districts with poverty rates above the national average of 38.2 percent experienced higher food inflation rates. The economic cost of climate change in Rwanda is estimated at USD3 billion, with an additional 1% of GDP per year by 2030, rising to 4% by 2050.

Lack of finance for development and high costs of finance: The local cost of credit is high and ranked as the most important constraint by business. Commercial lending rates average 18 percent. Banks hesitate to lend to productive sectors seen as risky, like agriculture, mining, and manufacturing. The high cost of borrowing limits access to capital, and technology that would otherwise boost private sector productivity and competitiveness. Increased private finance requires a slow build-up of domestic savings, and de-risking of investment.

Informality: Rwanda's private sector is underdeveloped and dominated by low-value enterprises. The 2023 business survey reveals that 91.9 percent of businesses are informal, with MSMEs providing over 80 percent of private sector employment. Micro enterprises struggle with productivity and growth, due to a lack of economies of scale, and only 0.1%

[9]IMF Country Report No. 24/141.

engage in exports. The private sector has limited innovation and technological advancement, with a capacity utilization ratio of 42.91 percent.

2.3.2 Drivers and Opportunities to Accelerate Structural Transformation.

Governance: Good governance and strong institutions are critical for creating a conducive environment for macroeconomic stability and accelerating structural change. Literature highlights the importance of institutions like free markets, property rights, and the rule of law in fostering innovation, productivity growth, and structural transformation (Mathur, 2001; Solow, 1959). Rwanda excels in these areas, with the highest AfDB Country Policy and Institutional Assessment (CPIA) score of 5.08 in 2023. It ranks 10th out of 54 African nations in the 2022 Mo Ibrahim Index of African Governance (IIAG) and is the 4th least corrupt country in Africa according to the 2022 Transparency International Corruption Perception Index (CPI). Sustained business reforms have streamlined operations, enabling business registration in just six hours, and allowing most taxes to be paid online. The country's secure and transparent land tenure system ensures strong property rights protection. Rwanda's liberal visa regime places it among the top 10 in Africa's Open Visa Index, reflecting its openness to trade and free movement of people. Rwanda also holds the second-highest score on the Regional Integration Index (RII), and maintains an average tariff rate of 11.67 percent, well below the 16 percent benchmark. These institutional strengths lower barriers to investment and support structural transformation.

There is suppressed potential to raise agriculture productivity to support structural transformation and consequently, 62 percent of the workforce remains trapped in low productivity agriculture. This stagnation is due to land scarcity, high population density, challenging topography, limited mechanization and irrigation, inadequate skills, lack of access to finance, and high post-harvest losses. Accelerated structural transformation will occur only if the potential in agriculture is unlocked through commercial farming and establishing stronger backward and forward linkages with other sectors, allowing labor to relocate to other sectors of the economy.

Technological progress can significantly drive Rwanda's structural transformation by improving production methods, business practices, transportation, and access to information. The endogenous growth theory developed by Romer (1986), and Lucas (1988) emphasizes the "self-sustained nature of long-term growth which is, made possible by technical progress and innovation." This theory highlights that innovation, measured by total productivity, can overcome the limitations of diminishing returns on long-term growth, which occurs when additional labor is added to fixed capital under the Solow model. Following this literature, a 2021 growth accounting exercise of Rwanda's production function, based on the methodology proposed by Coulibaly et al. (2008), reveals that from 2000 to 2019, physical capital contributed 55 percent to economic growth, labor 23 percent, and only 22 percent to Total Factor Productivity (TFP). The relatively low contribution of TFP underscores the limited use of technology and innovation, which is constrained by a critical mass of professional researchers in the country's human accumulation process. Rwanda has been at the forefront of encouraging the use and adoption of ICT in Africa, but adequate numbers of skilled IT professionals are still lacking[10] to increase productivity in higher value activities and accelerate structural transformation. To unlock TFP to drive growth, the government should invest

[10]International Trade Administration, 2022. Rwanda Country Commercial Guide – Telecommunications,

in Science, Technology, Engineering, and Mathematics (STEM) education and vocational training, increase funding for Research and Development (R&D), and promote ICT adoption across all sectors. Enhancing Public-Private Partnerships (PPPs), improving ICT, and transportation infrastructure, streamlining regulations, protecting intellectual property, and offering competitive incentives to attract and retain skilled professionals are crucial. Additionally, increasing digital literacy and expanding e-government services will further support technological progress, and sustainable economic growth.

Quality of public infrastructure as an enabler of structural transformation: For a small and landlocked country like Rwanda, the quality of its infrastructure plays a key role as an enabler of sustainable growth, and structural transformation. Good transport connections are required to enable the country to integrate with other economies around it, achieve economies of scale and become internationally competitive. Good communication networks are also key to realize the goal of becoming a service hub. Cheap and reliable power is necessary to reduce the cost of production and encourage private sector development. Rwanda has made remarkable progress in building the required infrastructure for transformation, Table 3 provides a summary of key indicators of Rwanda's progress in infrastructure development from 2012 to 2022.

However, the quality of infrastructure in Rwanda's is still considered underdeveloped, ranking at 71 out of 144 economies on the global competitiveness report for 2019, with an aggregate score of 51/100. It ranks 38/144 on the quality of transport infrastructure, 118/144 on utility infrastructure, and ranks 111/144 on ICT adoption. Section 2.3.4.2 provides more details on how infrastructure constrains growth. Rwanda needs good quality and cheap infrastructure to unlock productivity and compete favorably in the global markets.

Political issues: Rwanda's political settlement is uniquely well aligned with development. This was a deliberate strategic choice to promote inclusive growth in order to address the underlying causes of persistent conflicts in the past. This is manifested in a meaningful and long-term vision for the country – captured in vision 2050, a strong focus on policy and systems, low levels of corruption, international branding in peacekeeping operations, and as positioning the country as a source for a proof concept for new investments in Africa. Since 1994, the ruling RPF has created state-owned enterprises

Table 3: Key Infrastructure Development Indicators for Rwanda 2012-2022

	2012	**2022**
Energy		
Access to Electricity (% of Population)	16.8	61
Access to Clean Cooking (% of Population)	0,5	5,4
Installed Power Generation Capacity (MW)	108	353.4
Share of Renewables in the Energy Mix (%)	47	50.9
Water and Sanitation		
People Using Safely Managed Drinking Water Services (% of Population)	56	65
People Using Safely Managed Sanitation Services (% of Population)	73	88
Freshwater Withdrawal as a Proportion of Available Freshwater Resources (%)	13	20 (2020)
Transport		

Source: AfDB compilation for the Country Development Effectiveness Report 2024.

in telecom, banking, and manufacturing to address market failures where private investors saw high risks. These enterprises can, however, be seen as tools to entrench the elite and crowd out the private sector as has been the case in many emerging economies. Booth and Golooba-Mutebi (2012) argue that RPF-owned firms, especially through Crystal Ventures, have played a crucial developmental role, similar to active industrial policy. A 2014 World Bank study found these companies filled gaps where private investors were reluctant to invest, due to perceived risks . Rwanda's anti-corruption stance and developmental model prioritize citizens' interests over those of individual elites, helping to prevent elite capture.

Climate change as an opportunity to mobilize finance for economic transformation. Rwanda can harness climate change to drive structural transformation. In January 2023, it became the first African country to access the IMF's Resilience and Sustainability Facility, securing USD319 million in concessional financing for climate resilience. By June 2023, Rwanda and its development partners announced a cooperative approach to facilitate PPPs, scale up climate finance, and attract private investment. Rwanda aims to mobilize an additional €300 million to build further climate resilience and meets obligations under the Paris Agreement, targeting a 38 percent reduction in Greenhouse Gas (GHG) emissions by 2030 compared to Business-as-Usual (BaU), translating to an estimated mitigation of up to 4.6 million tons of carbon dioxide equivalent (tCO_2e).

2.4 Finance to Fast-Track Rwanda's Structural Transformation.

Rwanda's Vision 2035 outlines an ambitious long-term development plan aiming to increase GDP per capita from USD837 in 2019 to USD4,036 by 2035. This requires an annual growth rate of 12.6 percent until 2035, and 10 percent from 2035 to 2050. These goals are highly ambitious. From 2000 to 2019, the highest per-capita growth rates among 194 countries were 8.8% for Myanmar, and 8.4% for China (World Bank 2022). Vision 2050 plans to achieve these targets by enhancing human capital, and improving infrastructure, including water, energy, and transportation. These improvements aim to reduce business costs, boost productivity, and achieve structural transformation A 2023 AfDB growth trajectory study (2022 – 2035), using cross-country evidence, shows that to reach middle-income status, the country must raise labor productivity and achieve a HCI of 0.486, while spending USD129 per capita on health, and education. Currently, Rwanda's HCI is 0.380, and it spends USD47 per capita on health, and education. To close the labor productivity gap and reach the median lower-middle-income country level, Rwanda needs to increase its per capita spending by 176 percent.

As shown in Figures 5 and 6, the AfDB estimates that Rwanda will need USD3.4 billion annually by 2030 to support critical investments for structural transformation. There is a financing gap of USD2.9 billion to meet the African Union's sustainable development agenda and catch up with other developing countries. The largest portion of this need, USD1.7 billion, is for productivity-enhancing infrastructure, with an annual financing gap of USD1.6 billion.

2.5 Closing the Financing Gap Through Domestic Resource Mobilization.

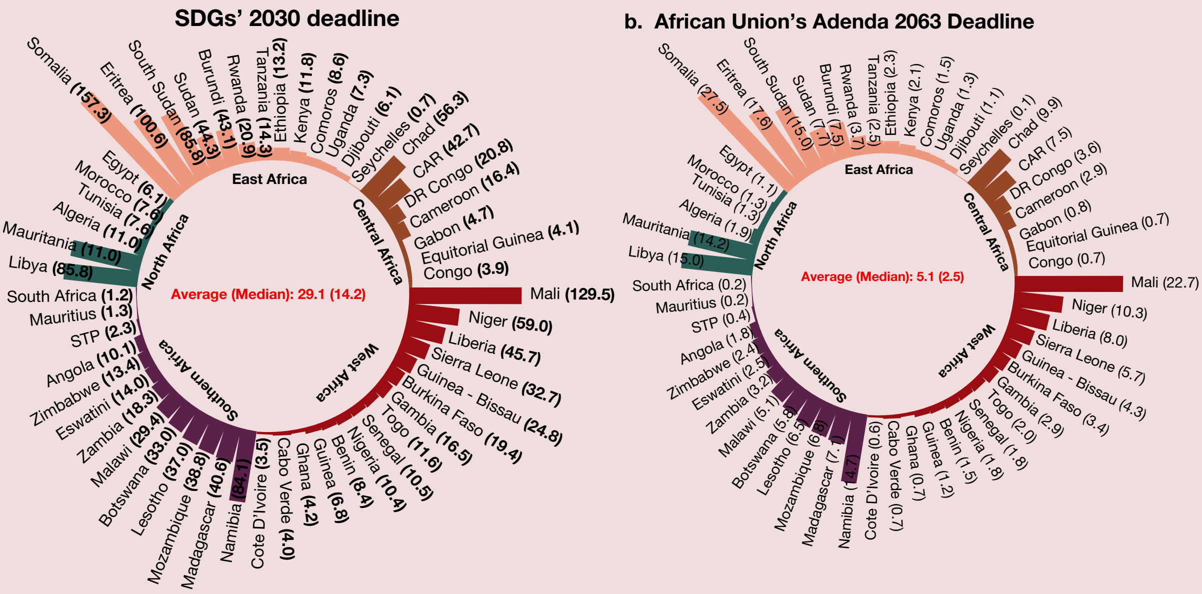
To achieve structural transformation through investment in infrastructure and human capital, the government will have to weigh investment financing options that generate optimal results. The growth trajectory study by AfDB in 2023 established that, without significant policy changes, that leaves the annual GDP growth rate at 7.0%, and in 2035, limited structural transformation will be achieved. However, with policy interventions targeting additional financing (2% of GDP between 2027 and 2031) for infrastructure, and raising spending on health and education to the medium of lower middle-income countries, the maximum simulated gains compared to base are additional 1.6% for GDP growth, additional poverty reduction to 20 percent, and a consumption gain of 108 percent, compared to 2022, signifying structural benefits to the economy.

2.6 Concluding Remarks and Policy Recommendations.

Rwanda's vision 2035 has set stretching ambition to promote industry, services model to become an upper middle-income country with a PCI of USD4035, however the desired human, physical capital, and technological investments required to accelerate this process through structural transformation seem to have stalled. The analysis shows that Rwanda's productivity growth from 1991 to 2018 has been primarily driven by structural change, specifically the shift of labor from agriculture to other sectors. However, this has not translated into substantial within-sector productivity gains, limiting the potential for sustainable and inclusive growth. Comparative insights from Developing Asia also reveal that initial productivity growth came from shifting labor from agriculture to manufacturing and services. Over time, the region increasingly focused on innovation and technological advancements in the service sector. Rwanda should adopt similar strategies by promoting diversification and fostering innovation.

The analysis also shows that while Rwanda has successfully addressed many regulatory and institutional barriers through sustained reforms, and demonstrated a strong political will to drive transformation, the country still faces significant challenges, including limited skills, technological adoption, infrastructure deficits, and weak sectoral linkages. On fiscal constraints and resource mobilization, the analysis established that: managing the fiscal space required for structural transformation is complex. Relying solely on tax financing could reduce household consumption,

Figure 5: Estimated Annual Financing Gap (Percent of GDP) by African Countries for Structural Transformation by 2030 and 2063



while excessive foreign borrowing might increase debt. A balanced approach is needed to finance transformation effectively.

In view of these challenges, the following policy action are proposed to unlock the productivity of the economy to fast track structural transformation:

- Invest in education and vocational training tailored to the needs of the manufacturing and high-value service sectors. This will equip the workforce with necessary skills, promoting labor movement to higher-productivity areas.

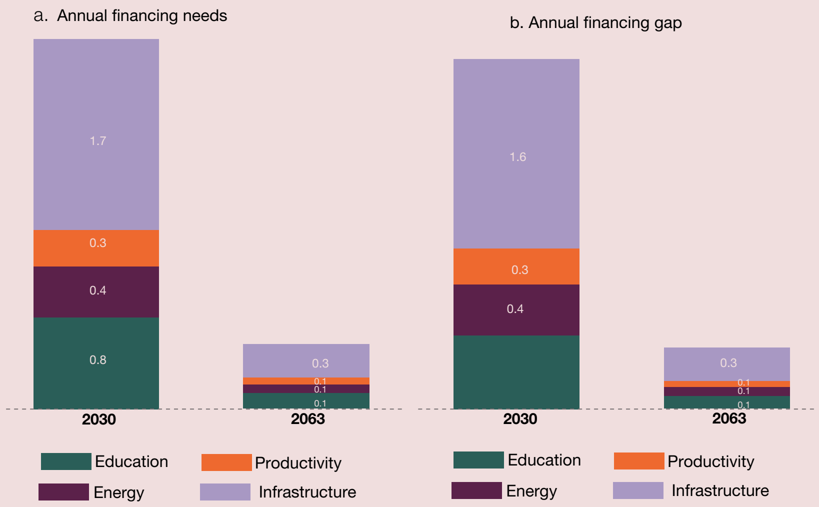
- Improve infrastructure, including transportation, energy, and digital networks, to support industrial, and service sector growth.

- Promote diversification and innovation: support manufacturing and services: Create a conducive environment for the growth of manufacturing and high-value service industries through targeted investments, regulatory support, and infrastructure development and encourage innovation and technological adoption in the service sector by investing in R&D, and supporting digital transformation initiatives.

- Increase productivity of the agriculture through commercial agriculture and strengthen its the linkages with industry and services to maximize productivity across the sectors and allow labor to relocate freely in sectors with high productivity and obtain jobs.

- In the context of the constrained fiscal space, stay the course on fiscal consolidation by (a) curbing growth in unproductive spending, and (b) carefully considering the trade-offs between mobilizing fiscal space from taxes, and foreign borrowing.

Figure 6: Estimated Annual Financing Gap (Percent of GDP) by African Countries for Structural Transformation by 2030 and 2063



3

FINANCING STRUCTURAL TRANSFORMATION IN RWANDA: THE NEED FOR REFORMS OF THE INTERNATIONAL FINANCIAL ARCHITECTURE

KEY MESSAGES

- Rwanda's plan for structural transformation requires significant investments in infrastructure, human capital, climate action, and technology to boost productivity. However, the country faces challenges in raising funds, due to low domestic resource mobilization capacity and faces limited access to external sources under the current rigid global financial architecture. Reforming this architecture is essential to meet the needs of developing countries, enabling countries like Rwanda to access concessional resources, secure climate finance, attract private capital, and build capacity for the domestic financial markets to support accelerated economic transformation.

- Rwanda has actively advocated for reforms in the global financial architecture, primarily through the G20 Compact and United Nations. It has also set up a robust domestic development partner framework to support its efforts to mobilize additional resources at competitive terms for transformative, sustainable, inclusive, and climate smart investments. However, greater coordination with regional partners is necessary to amplify the African voice, and negotiation capacity. This is crucial for advocating a global financial architecture that is more responsive to the needs of African countries.

3.1 Introduction

The country's overall growth record since 2000 has been strong, however, it should be noted that the official objective of becoming an upper middle-income country by 2035 does not seem realistic since, given the level of GDP per capita in 2022, this would require an average annual per-capita growth rate of 12.4 percent for the period between 2023-2035, a rate that is well above the rate achieved by any country during the period between 2000-2019.

Rwanda has actively advocated for reforms of the global financial architecture through the G20 Compact and United Nations, emphasizing the need for a responsive financial architecture to support transformative, sustainable, inclusive, and climate-smart investments.

To achieve structural transformation through investment in infrastructure and human capital, the government will have to weigh investment financing options that generate optimal results. Growth diagnostics and trajectory study by AfDB in 2023 established that, without significant policy changes, the annual GDP growth rate at 7.0% until 2035 will only lead to limited structural transformation. However, with policy interventions targeting additional financing (2% of GDP between 2027 and 2031) for infrastructure, and raising spending on health and education to the medium of lower middle-income countries, the maximum simulated gains compared to base are additional 1.6% for GDP growth, additional poverty reduction to 20 percent, and a consumption gain of 108 percent, compared to 2022, signifying structural benefits to the economy.

Among the different fiscal space sources, relying on tax financing for the additional expenditure avoids adding to foreign debt, but comes at the cost of a loss in household consumption in the years when the gains from the policy changes are still modest, while additional spending is high. If policy programs were accompanied by government efficiency gains (in the form of reduced growth in government consumption), outcomes would be more positive, implying less need to raise taxes or borrow abroad.

From a policy perspective, the results point to the importance of: (a) curbing growth in unproductive spending; (b) strong management of the programs in health, education, and infrastructure (which may involve efforts ranging from initial project design to monitoring and evaluation to learn from experience); and (c) carefully considering the trade-offs between mobilizing fiscal space from taxes and foreign borrowing. Politically, it may, for example, be attractive to rely more on borrowing during an initial stage when the payoffs from spending additions have not yet emerged – this will curb initial private consumption and investment losses – and after that, switch to stronger reliance on taxes. In all these areas, it is important to learn from experiences in Rwanda, and globally.

3.2 - Rwanda's Stand on the Need to Reform the International Financial Architecture

Rwanda has been one of the major proponents of the reforms of global financial architecture since the push begun, mainly through the G20 Compact. For example, during the March 2021 UN meeting on the International Debt Architecture and Liquidity (IDAL), President Kagame called for the extension of the G20 debt service suspension initiative for the foreseeable future; using IMF Special Drawing Rights (SDRs) to enhance liquidity, but with accountability on how they are allocated according to need; and debt relief negotiations to be conducted with welfare of citizens in mind, and with a long-term view of development objectives.

Rwanda has continued to push for the reforms of global financial architecture, suggesting examples of how various financial aspects can be handled differently and better, moving forward. Examples included: (i) accelerating the debt management process through the G20 common framework; (ii) that rich countries should continue to honor the commitment to allocate part of their special drawing rights to lower-income and developing countries, based on need and not on wealth; (iii) having more private investment and financing, noting that financing from the multilateral banks will never be sufficient; (iv) to significantly simplify and speed up the process of approving loans and disbursements from IFIs; and (v) that developing countries were unfairly paying high-risk premiums, and everyone is lumped together according to the lowest common denominator. We need to work together to address this. These are extra costs that come on top of the already high interest rates

3. 3 - Mobilizing Additional Resources for Rwanda's Structural Transformation

As alluded to in Chapter 3, Rwanda's major challenges to structural transformation emanate from demography, climate change, high levels of informality, and public sector led development ideology. Rwanda, with a population of over 13.2 million and a surface area of 26,338 km², is Africa's most densely populated country at approximately 503 inhabitants/km². Leveraging its demographic dividend, Rwanda must improve education, health, and skills to boost labor returns. Coupled with climate change related phenomena that cost almost 2% of the GDP, large informal, medium scale businesses (more than 80 percent of the economy) and public sector driven investment and growth, the country would need substantial amount of resources to achieve industrial transformation.

In terms of actual resource inflows, in 2022/23, external development finance to the public sector continued to be the largest source of finance – at USD1.597 billion or 53 percent of USD3.013 billion in total inflows. This is an increase of 33 percent from 2016/17 to 2022/23, with the total exceeding USD3 billion for the first time. Disbursements to civil society through International Nongovernmental Organizations (INGOs) were USD268.2 million, or about 9% of the total finance. Total flows to the private sector were USD658.3 million (22 percent), with about USD56.0 million in investment specifically from DFIs. Remittances continue to increase and totaled USD489.89 million or 16 percent of total inflows. These external financial flows are still not adequate for additional resources needed to finance structural transformation, estimated at additional 2% of GDP to finance infrastructure, and additional financing for human capital at a level equal to the median of lower middle-income countries.

The Bank is assisting the government to mobilize concessional financing from international financial markets by leveraging on ADF's country allocation as a PCG. The proposed PCG operation aims to raise Euro 200 million to finance future sustainable development projects in the country, using USD50 million from ADF-16. These are geared towards enhancing structural transformation in the country.

In terms of fiscal reforms, prudent expenditure prioritization helped to contain the fiscal deficit within a single digit in the post COVID-19 era: the fiscal deficit including grants stood at 8.5% of GDP in 2021 before declining slightly in 2022 and 2023. The budget for the year 2023/24 amounts to USD5 billion, representing an increase of 6% from the previous fiscal year's budget. About 59 percent of the budget is financed from domestic revenues, external grants (13 percent), external loans (24 percent), while domestic borrowing, and financial assets drawdown account for 4%. The fiscal deficit is projected at 6.8% in 2024 and 5.6% in 2025, due to continued implementation of the fiscal consolidation strategy, and improvement in tax revenue mobilization. The government is making efforts to expand the task base, address tax expenditure, and stimulate growth as ways of mobilizing additional domestic revenue.

The 2022 Public Expenditure and Financial Accountability (PEFA) assessment established that aggregate fiscal discipline was sound, strengthened by the reliability of aggregate revenue, and expenditure outturns, as well as the reasonable level of composition variances on both revenues, and expenditures. Fiscal discipline was also strengthened by the low levels of in-year budget reallocations, done within clear guidelines and strict limits, as well as a robust, and verifiable macroeconomic framework that supported revenue projections.

3. 4 - Dealing with Rwanda's Debt

Rwanda's total public debt decreased from 71.3 percent (2022) to 66.6 percent (2023) of GDP in relative terms, due to a higher nominal GDP post-COVID-19 recovery. External debt dominates (53.7 percent of GDP), with 75.6 percent being concessional debt from multilateral development agencies. Structural shifts in aid flows, and high investment in key infrastructure sectors (energy, transport and water, and sanitation) have driven recent debt growth.

Multilateral creditors account for 56.7 percent of total debt. Bilateral creditors account for 9.5% and domestic creditors at 24.5 percent. In terms of currency, 46.2 percent of total outstanding debt by the end of 2022 were in SDR, implying significant portion coming from multilateral institutions (IMF, International Development Association (IDA), and International Fund for Agricultural Development (IFAD)) which provided their loans in SDR denomination. USD followed with 27.3 percent, EURO by 12.7 percent, Chinese Yuan by 5.4%, and Japanese Yen by 4.1%.

Under joint Debt Sustainability Analysis (DSA) by the IMF and the World Bank (November 2023), Rwanda's debt was assessed as sustainable with a moderate risk of external, and overall public debt distress. The high concessional composition keeps debt affordable. Moody's global rating agency upgraded Rwanda's credit rating from B negative in 2022 to B positive in September 2023, affirming the country's creditworthiness, and its ability to meet financial and debt obligations.

The biggest challenge with Rwanda's debt management is low absorption reflecting in poor disbursement, especially to the productive sectors of the economy. Between 2017/18 and 2022/23, disbursements to the social sectors (health, education, and social protection) rose by 73 percent from USD373 million to USD647 million. Disbursement to the productive sectors (energy, transport, agriculture, water, and sanitation) fell by 28 percent from USD480 million to USD347 million. This trend was attributed to the fact that social sectors largely received budget support, while productive sectors relied largely on investment projects which suffered from sow procurement, thereby delaying project implementation, and attendant results. The slow procurement was also a result of low capacity within implementing agencies to process the disbursement requests through the systems of various development partners. The structural rigidities also left large sums of disbursed amounts, reportedly USD1.5 billion in mid-2023, sitting in various bank accounts awaiting finalization of procurement processes.

Rwanda's Medium-Term Debt Strategy (MTDS) 2023/2024 through 2025/26, articulates the country's ambitions to meet its financing needs, while minimizing costs and prudently managing risks. In the context of declining concessional financing, MTDS emphasis is towards semi-concessional debt as a preferred option with a target of achieving debt to GDP ratio of 65 percent by 2031. In September 2023, Moody's raised Rwanda's sovereign rating to B2 (sub-investment grade) and changed the outlook from negative to stable, due to the government's commitment to fiscal consolidation, and revenue enhancement, keeping debt burden on a stable and declining path.

3.5 - Financing Climate Action

Rwanda is one of the most highly vulnerable countries to climate change globally and in Africa. According to the Notre Dame-Global Adaptation Index (NDGAIN) 2021, at position 154 out of 185 ranked countries, Rwanda was one of the most climate-vulnerable countries, but with relatively high readiness, ranked at position 88 out of 192 countries. Rwanda is disproportionately affected by extreme risks from floods and droughts which threaten development gains, and risk pulling people into poverty. In May 2023, for example, the Western and Northern Provinces of Rwanda were hit by heavy rains that caused floods and landslides, affecting more than 10,942 households. In January 2024, at least 4,309 households, being temporarily sheltered by the government, were earmarked to be resettled in risk-free areas.

The country has made good progress in developing national green growth frameworks, roadmaps, and targets, all of which emphasize the role of the private sector in generating the finance needed to meet set targets. In May 2020, Rwanda became the first African country to submit its enhanced Nationally Determined Contribution (NDC) to the United Nations Framework Convention on Climate Change (UNFCCC), committing to a reduction in GHG emissions of up to 38 percent compared to BaU by 2030. This was equivalent to mitigation of up to 4.6m tons of carbon dioxide. The reduction effort was estimated to cost USD11 billion, comprising USD5.7 billion for mitigation, and USD5.3 billion for adaptation. In June 2023, the country launched its revised Green Growth and Climate Resiliency Strategy (GGCRS)with USD2 billion required annually for its implementation, of which approximately USD700 million will come from the government.

The country has introduced special financing instruments for climate change, including the following: (i) Intego (or NDC Facility), launched in March 2023, Intego has a capitalization of EUR 46 million grant from Kreditanstalt für Wiederaufbau (KfW) as part of the Rwandan-German Climate and Development Partnership. Intego provides financial and technical support to climate change adaptation and mitigation projects. Funding priorities range from green growth, climate action, and environmental protection. Intego marks another key milestone for Rwanda and is a clear reflection of the country's commitment to put people and the environment at the forefront of sustainable development. (ii) In October 2023, the Development Bank of Rwanda (BRD) issued an innovative Sustainability-Linked Bond (SLB) to support Rwanda's sustainable economic development objectives. This was the first SLB issuance in East Africa and the first issuance by a national development bank globally. The SLB was partially credit enhanced by the World Bank. (iii) Rwanda's Green Taxonomy covering selected sectors (agriculture, energy, transport, and construction) that represent 75 percent of all emissions was launched at the United Nations Climate Change Conference (COP28) in December 2023. (iv) In terms of support to the private sector, the Ireme Invest, a groundbreaking investment facility established in 2024 by the Rwanda Green Fund and BRD with support from a range of development partners, it is a one stop center for green and sustainable investment which was launched with an initial capitalization of USD104 million to support the private sector to access green finance. It takes a holistic and value-chain approach to address the existing roadblocks in access to finance through a Project Preparatory Facility (PPF) managed by the Rwanda Green Fund, and a Credit Facility managed by the BRD.

In addition to the financing instruments, in September 2023, Rwanda approved its Carbon Market Framework. The framework establishes a governance and institutional structure that will guide Rwanda's participation in the carbon markets. Rwanda is committed to mobilizing financing for climate action without contributing to public debt accumulation.

3.6 - Policy Recommendations

As a strong proponent of Global Financial Architecture reforms, Rwanda should continue its engagement in global networks advocating these changes. Key priorities include:

- Simplifying climate finance procedures to make them accessible to climate-vulnerable countries like Rwanda, which struggle with complicated and costly project preparation requirements.

- Advocating for accelerated and scaled-up low-cost concessional financing for Africa, including channeling SDRs into MDBs to increase development finance.

- Encouraging G-20 members to replenish the concessional windows of MDBs adequately.

- Reforming global tax governance to enhance transparency, and inclusiveness.

- Maximizing MDB funding capacity by implementing the G20's Capital Adequacy Framework, and Triple Agenda.

- Improving the scale and transparency of financing from bilateral creditors.

Rwanda should also advocate for global debt architecture reforms to make it more transparent, agile, accessible, and affordable for developing countries. This includes devising market-based solutions to unsustainable Eurobonds, and providing debt relief to free resources for climate actions. Considering proposals for a sovereign debt authority, and insolvency system. Encouraging G20 countries to enact legislation that incentivizes private lenders to participate in debt workouts.
Having pioneered the mobilization of the IMF emergency climate facility, Rwanda should continue to play a leadership role in facilitating peer-to-peer learning on leveraging these resources and preventing overlapping climate shocks to many African countries.

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