A REVIEW OF EXISTING AND POTENTIAL ENVIRONMENTAL FISCAL REFORMS AND OTHER ECONOMIC INSTRUMENTS IN RWANDA

(i) Objectives;

The objective of the study on Environmental Fiscal Reform in Rwanda was "*to improve national funding levels for investing in environmental sustainability. This will involve exploring opportunities for raising revenues, while creating incentives that generate environmental benefits to support poverty alleviation efforts*."

Although Rwanda is credited internationally on making positive strides toward achieving MDGgoals, about 57% of Rwandans, a majority of them women, still live under the poverty line[1], surviving on less than US$1 per day. This creates conditions in which a majority of Rwandan lack access to basic livelihood needs including water and sanitation.. To help achieve the MDGs, developing country governments need to raise revenues to invest in schools, healthcare, infrastructure and the environment. Environmental Fiscal Reform (EFR) can play an important role in this regard, helping countries raise revenues, while creating incentives that generate environmental benefits and support poverty reduction efforts. EFR has the potential to free-up economic resources and generate revenues that can help finance poverty reduction measures, for example infrastructure that improves access of the poor to water, sanitation and energy services. By encouraging more sustainable use of natural resources (such as forests or fisheries), reducing pollution from energy use and industrial activities, and stimulating the use of innovative "clean" technologies, EFR can also improve management of the environment. In these ways, EFR can directly and indirectly address environmental problems that threaten the livelihoods of the poor. In recognition of the potential of EFR in contributing to poverty reduction and economic growth, the government of Rwanda with the support of PEI undertook a study on EFR/EI in order to build on and consolidate on national efforts towards sustainable development aspirations.

(ii) Methodology and definition;

In simple terms, the Environmental Fiscal Reform according to the study encompasses *strengthening the implementation of existing fiscal instruments for environmental management and introducing new ones where they may be required. It is a strategy that redirects government's taxation and expenditure programmes to create an integrated set of incentives to support shift to sustainable development practices. They encompass full cost pricing of natural resources, taxation, charges, tax rebates and exemptions, smart subsides and other forms of incentives.*

Further, the study highlights the triple benefits of EFR; namely environmental benefits, fiscal benefits and poverty reduction benefits:

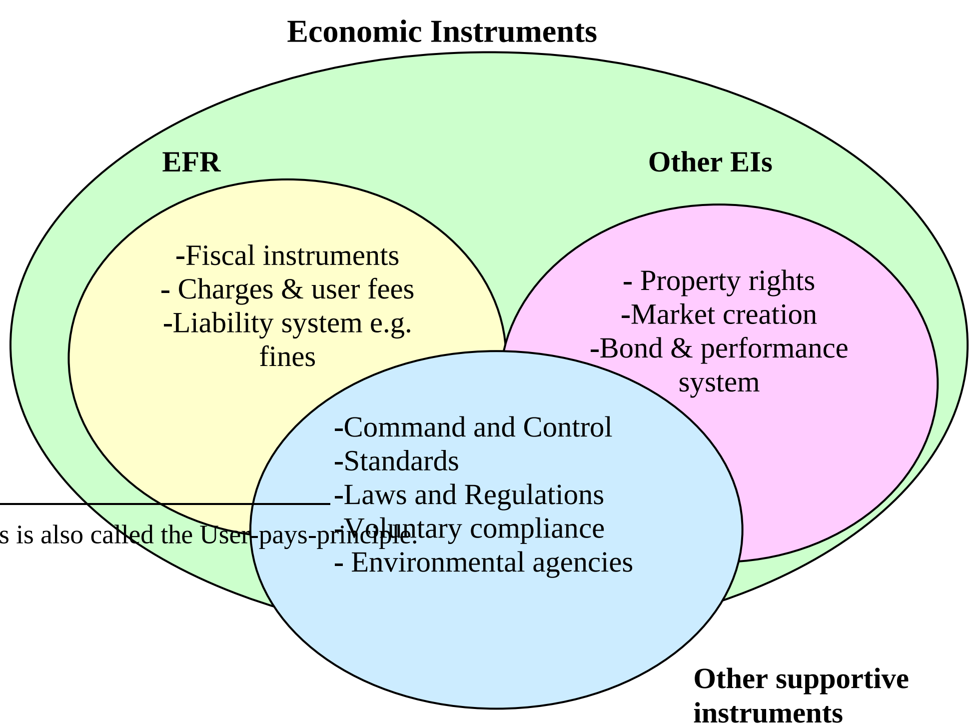
[1] MINECOFIN (EICV), 2007

1) Firstly, EFR helps to ensure environmental sustainability in accordance with two main principles: the **polluter-pays-principle** and the **beneficiary-pays-principle**[2].
2) Secondly, EFR may contribute to the generation of substantial revenue and fiscal discipline. This is very important to the Government of Rwanda (GOR) aspiring to broaden revenue base and to level the play ground for fair competition. EFR also frees up government resources by making the private sector and communities, for example, take the lead in managing some of the environmental problems. They are able to do that because of the incentives provided under EFR.
3) Thirdly, the revenue generated is not only partly reinvested in the Environment and Natural Resource (ENR) sector but it also finances other sectors that benefit the poor like education, health and good governance.

The main rationale for the study is that the government is challenged to maximise the triple benefits from EFR/EIs mentioned above and to make informed trade-off choices where they may be absolutely necessary. Managing that challenge cannot be left to chance because EFR/EIs have a direct bearing on the budgeting and fiscal discipline because some are public expenditure instruments while others are revenue generating instruments.

It should further be noted that the study covers also other economic instruments which equally deliver on the same benefits as mentioned above but which are not of fiscal nature. They include property based instruments, Market creation, financial instruments and bond and performance systems. These instruments and EFRs collectively belong to a class called economic instruments for environmental management. (Figure 1).They are termed so to convey the message that their effect is to use **costs** and **benefits** to influence investment and consumption decisions in such a way that alternatives are chosen that lead to an environmentally more desirable outcome than in their absence [OECD, 1994].

Figure 1: EIs and other instruments for environmental protection and natural resource management



[2] This is also called the User-pays-principle.

In terms of scope, the study reviews the existing EFR/EIs, identifies potential ones and draws policy, legal and institutional implications for implementation of a successful EFR/EI programme in Rwanda. An assessment of existing and potential EFR/EIs was done for the following sectors: Lands, Mining, Forestry, Water, Housing, Waste, Transport, Energy, Agriculture, Industry, Trade, Wildlife and tourism and Finance and banking.

Literature review and analyses of secondary sources were applied in addition to a wide range of interviews with representatives from the key institutions, such as Ministry of Economy and Finance, REMA, sector ministries and research institutions. Interviews were also held with district staff in order to obtain decentralized information.

(iii) Key Finding/Recommendations;

The report has shown that the poverty levels and challenges of meeting the MDGs in Rwanda are closely linked to widespread environmental degradation. The challenge is further complicated by the fact that the economy is not sufficiently financed to address them. For example, the Public Expenditure Review for environment also done under the auspices of PEI showed that (i) the tax revenue has failed to even cover the recurrent expenditure since 2004, and the gap is not narrowing down despite impressive revenue collection rates by Rwanda Revenue Authority, and (ii) of the total public expenditure on budget in 2008, the environment and natural resources sector spent only 1%[3]. To some extent, EFR can contribute some revenue although Rwanda's case has to be put in perspective. It has a narrow economic base. It is not yet able to generate savings from trade. Accordingly, it has to use EFR among other policy instruments to stimulate the growth of Gross Domestic Product (GDP) and disposable income.

Further, the report has highlighted that the government has been extending EFR based incentives although it did not announce them as such. They were introduced through legislations for investment, customs, Value-added tax, personal and corporate tax, and consumption and through sectoral legislation. There are opportunities for introducing more over time.

In view of the fact that EFR/EIs cut across many sectors in Rwanda, they should centrally be coordinated so that their overall impacts on the national budget, environmental sustainability and poverty reduction can systematically be measured, monitored and reported. However, a proper institutionalisation of EFR/EIs has been missing. Another motivation for coordination is that EFR have implications for fiscal discipline. In most of them, the government has been forfeiting revenue by extending exemptions. In others, it has been raising revenue. It is thus imperative that MINECOFIN spearheads the coordination in close cooperation with Rwanda Revenue Authority, REMA among others. The case for coordination is further strengthened by the fact that EFR have to be assessed

[3] The report on Public Environmental Expenditure Review is available from REMA, Rwanda

for their likely impact through the six transmission channels of price, transfers, employment, access, assets and authority.

It has equally been shown that it is not always enough to introduce EFR. The government has to go a step further sometimes to provide other interventions before their impacts for environmental sustainability can be felt. For example, in as much as the government exempts solar equipment and accessories from customs, the access of solar is not yet popular. There are barriers to be overcome like providing soft loans to pay upfront for the equipment, training technicians for maintenance, creating awareness to mention but a few. Another example to highlight relates to giving access to the poor to use the natural resources like marshlands, forest products and wildlife for non-consumptive uses or eco-tourism. Communities have to be made aware about these opportunities using simple and understandable guidelines. The capacity of their local institutions has to be built. The government of Rwanda, and in particular the environment sector has put in place a strategy for focus capacity building at local levels for enhancing livelihoods through integrated management of environment and natural resources.

The recent integration of Rwanda into the East African Community is bringing a new dimension. Rwanda has to monitor the EFR regimes in other member states. An example has been given in this report how the countries in the same Community are having different taxation regimes for second hand equipment like fridges, second hand computers and electronic waste.

It has to be noted that EFR is bringing new demands. Their spread in several sectors and the introduction of additional ones should be matched with parallel investment in awareness creation, the formulation of environmental standards, regulations and building institutional capacity for monitoring and enforcement. Sectoral staff has to be trained to appreciate and value the natural resources. Short of that, the prices they negotiate in forest harvesting, mining, water extraction etc may not reflect the full cost. Several of such situations drive the government always to borrow to invest in these sectors. EFR is also bringing implications for coordination, systems development for capturing the impacts of EFR and equipping some mandated institutions to carry out inspections and testing.

Ideally, capacity building for EFR should be placed within the bigger picture of capacity building for sustainable development. That capacity building would have components targeting central government ministries, semi-autonomous government agencies, districts, communities, NGOs, the media, private sector, the enforcement agencies and parliamentary committee responsible for overseeing ENR. In content, the capacity building programme would cover among others, inter-institutional coordination, environmental planning, formulation of standards, regulations and guideline; environmental mainstreaming and budgeting, environmental monitoring and reporting and environmental enforcement.

Presently, there is wide spread earmarking of funds e.g. National Water Fund, National Forestry Fund, and of recent, there is talk of Climate Change Adaptation Fund.

Government is conducting a study on how to rationalize them. That may also have a bearing to the operationalisation of yet another fund, the National Fund for Environment, abbreviated as FONERWA in French. The establishment of FONERAWA is provided for under the Organic Law No 04/2005 determining the modalities of protection, conservation and promotion of environment in Rwanda. Although separate concept note for FONERWA has been prepared[4], suffice it to mention that a proposal to merge the several similar funds above has been advanced both in the concept note and this report.

(iv) Use of study findings in PE mainstreaming (advocacy/policy dialogue/capacity development)

The EFR report was finalized in its current version in August 2010. Its preliminary findings were presented during training for Parliamentarians organized by REMA and PEI on the 17th of June 2010 and the case was made for increased environmental financing and for the Parliamentarians to play an important role in the implementation of EFR by:

- Emphasizing the need for close monitoring of the impact of existing and/or potential EFR
- Continuing to invest in reporting extra-budgetary on extra funds including revenue generated by ENR. Proper identification and characterization of ENR-based revenue constitutes significant milestone in the institutionalization of EFR/EIs and is likely to trigger further interest in sustainability principles for most sectors. This is the key benefit that is emerging with the EFR study undertaken by REMA with PEI support.
- Engaging the government on processes that can trigger additional external incentives and resources
  - Funds in the name of climate change e.g. REDD
  - Funds under Clean Development Mechanisms and payment for ecosystem services
- Raising voice to ensure treasury provides reasonable seed funds for start-up;
- Promoting political momentum towards internal and external resource mobilization as was clearly evident during the session with Parliament where EFR generated particular interest as a viable input towards improving ENR management for poverty reduction;
- Broadening advocacy for sustainable financing to overcome the challenge of budget constraint

Moreover, the results from the EFR report have been used in training staff from planning and budget departments in key sector ministries in close collaboration with staff in Ministry of Finance and Economic Planning.

A separate concept note was developed as part of the EFR report, in support of the efforts by the Government of Rwanda to establish the National Fund for Environment (FONERWA). The formation of the fund was provided for under Organic Law No

[4] The concept note for the operationalisation of FONERWA is available from REMA,Rwanda

04/2005 and the concept note provides and discusses a checklist of important aspects that should inform the drafting of the Bill for establishing the National Fund for Environment in Rwanda. This concept note has been crucial in the policy dialogue as it represents an important potential for resource mobilization, and PEI will continue to advocate for the drafting of a Bill to eventually facilitate the operationalisation of FONERWA. Continued assistance will also be provided in order to establish specific Economic Instruments on the basis of the EFR, capacity building in extended cost – benefit analysis as a basis for green accounting all of which will serve as key inputs into payment for ecosystem services approach, a step that will move Rwanda ever more closer to the envisioned national sustainable development.