INTERNATIONAL DEVELOPMENT ASSOCIATION

PROGRAM DOCUMENT FOR A

PROPOSED DEVELOPMENT POLICY CREDIT
IN THE AMOUNT OF SDR 136.4 MILLION
(US$187.8 MILLION EQUIVALENT)

AND A

PROPOSED DEVELOPMENT POLICY GRANT
IN THE AMOUNT OF SDR 226.8 MILLION
(US$312.2 MILLION EQUIVALENT)

TO THE
FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

FOR THE
SECOND ETHIOPIA GROWTH AND COMPETITIVENESS PROGRAMMATIC
DEVELOPMENT POLICY FINANCING

February 20, 2020

Macroeconomics, Trade And Investment Global Practice
Africa Region

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The Federal Democratic Republic of Ethiopia

**GOVERNMENT FISCAL YEAR**

*July 8 – July 7*

**CURRENCY EQUIVALENTS**

Exchange Rate Effective as of January 31, 2020

Currency Unit = Ethiopian Birr (ETB)

US$1.00 = ETB 32.0606

US$1.00 = SDR 0.72624278

<table>
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<th>ABBREVIATIONS AND ACRONYMS</th>
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<td>AQR</td>
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<td>CBE</td>
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</table>
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Regional Director: Asad Alam
Practice Manager: Mathew A. Verghis
Task Team Leaders: Miguel E. Sánchez Martín and Mikul Bhatia
FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA
SECOND ETHIOPIA GROWTH AND COMPETITIVENESS PROGRAMMATIC DPF

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Peer reviewers for the operation are: Vivien Foster (Senior Advisor, GEEDR) and Ishac Diwan (Former Country Director, Ethiopia).
## SUMMARY OF PROPOSED FINANCING AND PROGRAM

### BASIC INFORMATION

<table>
<thead>
<tr>
<th>Project ID</th>
<th>Programmatic</th>
<th>If programmatic, position in series</th>
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<tbody>
<tr>
<td>P169079</td>
<td>Yes</td>
<td>2nd in a series of 3</td>
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</table>

### Proposed Development Objective(s)

This DPO series aims at boosting economic transformation in Ethiopia by increasing private sector participation and promoting good governance practices.

### Organizations

- **Borrower:** FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA
- **Implementing Agency:** MINISTRY OF FINANCE

### PROJECT FINANCING DATA (US$, Millions)

<table>
<thead>
<tr>
<th>SUMMARY</th>
<th></th>
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<tr>
<td>Total Financing</td>
<td>500.00</td>
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<table>
<thead>
<tr>
<th>DETAILS</th>
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<td>International Development Association (IDA)</td>
<td>500.00</td>
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<tr>
<td>IDA Credit</td>
<td>187.80</td>
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<tr>
<td>IDA Grant</td>
<td>312.20</td>
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</tbody>
</table>

### INSTITUTIONAL DATA

**Climate Change and Disaster Screening**

This operation has been screened for short and long-term climate change and disaster risks

**Overall Risk Rating**

Substantial
## Results

<table>
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<th>Indicator Name</th>
<th>Baseline</th>
<th>Update</th>
<th>Target</th>
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</thead>
<tbody>
<tr>
<td>Proportion of PPP contracts for which more than 4 bids are received:</td>
<td>0% (2018)</td>
<td>100 %&lt;sup&gt;1&lt;/sup&gt; (2019)</td>
<td>80% (2021)</td>
</tr>
<tr>
<td>Power sector has achieved cost recovery&lt;sup&gt;2&lt;/sup&gt;:</td>
<td>31% (FY2018)</td>
<td>N/A&lt;sup&gt;3&lt;/sup&gt;</td>
<td>75% (FY2022)</td>
</tr>
<tr>
<td>Power sector losses (commercial and technical):</td>
<td>23% (FY2018)</td>
<td>N/A</td>
<td>18% (2021)</td>
</tr>
<tr>
<td>Power sector debt service coverage ratio:</td>
<td>-1.84 (FY2017)</td>
<td>N/A</td>
<td>+0.5 (FY2022)&lt;sup&gt;4&lt;/sup&gt;</td>
</tr>
<tr>
<td>Number of days to clear export by customs:</td>
<td>5.5 (2018)</td>
<td>5.3 (2019)</td>
<td>4 (2021)</td>
</tr>
<tr>
<td>Percentage of type of license, permit, certificate, or other requirements that are automated under the Electronic Single Window:</td>
<td>0% (2018)</td>
<td>0% (2019)</td>
<td>66% (2021)</td>
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<tr>
<td>Price of 1GB of data per month as % of gross domestic product (GDP) per capita:</td>
<td>12.6 (2018)</td>
<td>N/A</td>
<td>5 (2021)</td>
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<td>Usage of mobile money, share of age 15+ population:</td>
<td>0.32% (2017)</td>
<td>N/A</td>
<td>5% (2021)</td>
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<td>Share of business activities required to obtain certificates of competence:</td>
<td>100% (2018)</td>
<td>23.8% (2019)</td>
<td>10% (2021)</td>
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<tr>
<td>Number of investment permits issued in sectors previously closed to foreign investors:</td>
<td>0</td>
<td>0</td>
<td>20 (2021)</td>
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<td>Credit to the private sector as a share of total credit:</td>
<td>30% (2018)</td>
<td>33% (2019)</td>
<td>37% (2021)</td>
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<td>Share of instruments at market rates in the total stock of government bonds:</td>
<td>0 (2018)</td>
<td>0 (2019)</td>
<td>10% (2021)</td>
</tr>
<tr>
<td>Percentage of CSOs registered by the Ethiopian Charities and Societies Agency under the new Proclamation:</td>
<td>0%&lt;sup&gt;5&lt;/sup&gt; (2018)</td>
<td>N/A</td>
<td>80% (2021)</td>
</tr>
<tr>
<td>Number of SOEs that have published on their website timely annual audited financial statements prepared using IFRS:</td>
<td>1 (2018)</td>
<td>N/A</td>
<td>9 (2021)</td>
</tr>
</tbody>
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<sup>1</sup> The first two PPP transactions approved have received five bids each. Currently, 17 more PPP projects are in the pipeline.

<sup>2</sup> Cost recovery is defined here based on the utilities’ net income in their audited financial statements, i.e. including operating cost, borrowing cost, and other cost items captured in the income statements.

<sup>3</sup> Initial data for January-April 2019 suggests that total monthly revenues increased by 61 percent compared to 2018. Cost data and the cost recovery will be available by end of 2019.

<sup>4</sup> Targets for cost recovery and debt service coverage ratio will be updated after the approval of the debt restructuring plan.

<sup>5</sup> Percentage calculated out of a universe of 3,000 Ethiopian Charities and Societies previously registered, some of which may have become inactive.
1. **INTRODUCTION AND COUNTRY CONTEXT**

1. This document proposes a Development Policy Financing (DPF) in the form of an IDA Credit of SDR 136.4 million (US$187.8 million equivalent) and an IDA Grant of SDR 226.8 million (US$312.20 million equivalent) to the Federal Republic of Ethiopia. The proposed operation is the second in a programmatic series of three DPFs and follows the World Bank’s first budget support operation to Ethiopia in over a decade. It supports implementation of the Government’s Second Growth and Transformation Plan (GTP II) 2016-2020 and the recently approved Homegrown Reform Agenda, advancing Ethiopia’s strategic vision toward becoming a lower middle-income country by 2025. The World Bank Group continues to partner with the Government, both technically and financially, as the reforms gather pace. The proposed operation is aligned with both the World Bank Group (WBG) Country Partnership Framework (CPF) 2018-2022 for Ethiopia and the WBG’s twin goals of boosting shared prosperity and ending extreme poverty.

2. Ethiopia, a growing economy with a population of over 100 million located in the conflict-affected Horn of Africa region, is experiencing unprecedented political and economic change. Since the appointment of a new Prime Minister, a peace agreement with Eritrea has been signed and the border has been reopened following two decades of conflict. While the political situation remains very fragile, the new administration has opened new political space for dialogue, released political prisoners, lifted bans on political parties and media outlets, actively engaged in regional diplomacy, and started to implement a range of economic reforms designed to revitalize the Ethiopian economy by expanding the role of the private sector. Given Ethiopia’s size and location, these shifts have the potential to transform the economic and political landscape in the Horn of Africa.

3. In the past 15 years, Ethiopia achieved strong economic growth, driven by large-scale public infrastructure investment. According to official data, GDP growth averaged 10.4 percent in 2004-2018, making Ethiopia one of the world’s fastest-growing economies. This has resulted in a dramatic increase in GNI per capita, from US$140 in 2004 to US$790 in 2018.⁶ Robust growth was driven by large-scale public investment in infrastructure, supporting strong growth in agriculture and services. This public investment has been financed by tapping external financing, keeping government consumption low, and deploying heterodox mechanisms such as controlled interest rates and financial repression. As a result, during this period, the share of the population with access to electricity tripled, the share with access to water doubled, and the length of all-weather roads almost quadrupled.

4. A dynamic private sector has started to emerge in recent years. Private investment surged from around 10 percent of GDP in FY11 to 25 percent of GDP in FY16, the last year for which data is available. Meanwhile, public investment remained around 15 percent of GDP over the same period. Fostered by the establishment of industrial parks and import exemptions, foreign direct investment (FDI) to Ethiopia increased from an average of US$0.4 billion in 2010-12 to US$3.7 billion in 2016-18, with the country

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⁶ GNI per capita in current US$, according to the Atlas Method. World Development Indicators.
overtaking Kenya, Tanzania, and Uganda in annual inflows (Figure 1). One-third of total FDI inflows originated in China as of 2015, and the manufacturing sector is estimated to account for about 85 percent of total FDI inflows. These inflows have been facilitated by policies that favor FDI in export-led sectors and that has resulted in some large investments such as the establishment of a Hyundai assembly plant in Addis Ababa. Going forward, private investment is expected to compensate for the projected decline in public investment. Projects currently in the Public-Private Partnership (PPP) Board pipeline amount to an estimated US$7 billion. In addition, the sale of new mobile licenses in the telecom sector and the opening to foreign investment of key sectors, including logistics, are expected to continue attracting large foreign investment.

Figure 1. Foreign direct investment inflows to Ethiopia and comparators

![Graph showing FDI inflows to Ethiopia and comparators]

Source: World Development Indicators.

5. Although Ethiopia has made significant progress on the Millennium Development Goals, it continues to face serious human development challenges. The poverty rate declined from 38.7 percent in 2005 to 23.5 percent in 2016. During 2005-2018, the under-five mortality rate per 1,000 live births was reduced from 123 to 55, while primary enrollment doubled and secondary enrollment increased tenfold. Life expectancy increased from 55 to 65 years and is now higher than the averages for both Sub-Saharan Africa (SSA) and low-income countries worldwide. Significant progress notwithstanding, maternal and child mortality rates remain high, as does the rate of stunting. Despite progress in access to education, only 57 percent of children starting first grade will complete ninth grade, and learning outcomes need further improvement. In addition, Ethiopia hosts close to one million refugees, primarily from neighboring Somalia, Sudan, South Sudan, and Eritrea, and the number of internally displaced persons (IDPs) is estimated to have reached 2.2 million, of which 1.6 million were conflict-related as of June 2019. Gender disparities are profound, and a combination of cultural norms and socioeconomic inequality greatly increases the risks faced by women. Although poverty rates have converged over time across regions,

7 Official national headcount index.
intra-regional and inter-woreda disparities are significant, and ethnic tensions are widespread. Income inequality has increased, with the Gini index rising from 0.30 in 2005 to 0.33 in 2016. Between 2011 and 2016, consumption growth for the bottom 15 percent was not statistically different from zero, in contrast to the top of the distribution where growth rates reached a maximum of just under 6 percent. The overall average consumption increased by 2.4 percent per year, while the median (50th percentile) grew at 2 percent per year. These numbers indicate that growth has not been pro-poor in Ethiopia.

6. **Despite achieving fast growth, the limitations of the state-led development model have become evident, as external competitiveness has eroded and imbalances have increased.** Notwithstanding substantial investments in infrastructure to support future growth, Ethiopia’s recent economic success has occurred in a context of modest structural economic transformation and still-incipient domestic private sector development. The shortcomings of the growth model have become apparent in recent years. For example, merchandise exports, dominated by coffee and oil seeds, dropped from 8.6 percent of GDP in FY11 to 3.4 percent in FY18, due to falling commodity prices and an overvalued currency. Poor export performance coupled with an ambitious public infrastructure investment agenda have placed the economy at high risk of debt distress. In addition, SOEs have increasingly crowded out the private sector, with the share of SOE credit in total outstanding domestic credit surging from 14 percent in 2007 to 54 percent in 2018. Some SOEs are not servicing their debt, thus exacerbating financial sector vulnerabilities. Finally, inflation has averaged 19 percent over the past six months, and entrepreneurs are reporting persistent foreign exchange shortages, with businesses needing to wait more than a year to obtain foreign currency.

7. **Recognizing the shortcomings of the previous development model, the Government has initiated the implementation of a comprehensive structural reform program.** Building on the objectives of GTP II, Ethiopian authorities unveiled a Homegrown Reform Agenda in September 2019 that complements the already initiated structural reforms, aimed at fostering private sector development by de-monopolizing economic sectors and introducing competition, with complementary measures to help tackle macroeconomic imbalances and reduce distortions. The IMF program approved in December 2019 in support to the macroeconomic policies envisaged in the Homegrown Reform Agenda will be complemented with the structural reforms under this DPF series. The government’s objective is to sustain the growth momentum of the past decade and create jobs for its young and growing population, with approximately 2 million new entrants joining the labor market each year.

8. **At the core of this DPF series is the understanding that, to achieve economic transformation and create enough quality jobs going forward, there is a need to open space for private sector solutions and increase the accountability of the public sector.** The first operation in this programmatic series boosted the initiation of reforms aimed at opening the private sector to competition and foreign participation and reforming state-owned enterprises (SOEs), efforts that are already bearing fruit. Achievements to date include:

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8 IMF Country Report No. 20/29.
• As a result of the tariff reform approved by the Council of Ministers in 2018, the average, volume-weighted price of electricity increased by 86 percent in January-April 2019 compared to 2018, and estimated total revenues increased by 61 percent. Tariffs had remained constant in nominal terms for over a decade, declining in US$ terms to 0.02 US$/kWh in 2018, the second-lowest tariffs on the continent, and this reform is helping power utilities move toward cost recovery. Improvements in service provision supported by accompanying sector reforms and programs are also starting to become apparent. The duration of electricity outages during the first half of FY20 was reduced by 24 percent compared to the first half of FY19, and an estimated 750,000 people got newly connected to electricity during FY19. However, severe load shedding during the second half of FY19, when drought conditions suppressed hydropower production, underscores the continued need for diversification of power supply sources through wind and solar power, as supported under the PPP-related prior actions of the DPF series.

• Following the public announcement that two new licenses for operators in the telecom sector will be issued, state-owned Ethio Telecom reduced prices (43 percent on mobile internet, 40 percent on voice call, 43 percent on SMS and 54 percent on broadband internet services) and improved the offering of services to the population.

• The country’s first projects developed under the new PPP Proclamation, two solar energy PPPs, were awarded in September 2019 at a price of US$ cents 2.56/kWh, the lowest-ever solar tariff in Africa and among the lowest globally. Despite this success, going forward, further dialogue is needed to address some currency convertibility and bankability issues related to infrastructure project finance, to ensure the best outcomes from future PPPs for the Government of Ethiopia.

• The lifting of restrictions on the participation of foreign firms in logistics services has already led to some high-profile investments involving DHL, Bollore Logistics, and CMA/CGM, who are partnering with Ethiopian Airlines and domestic private logistics operators. The streamlining of trading licenses and other business reforms continue to pave the way for further private sector development.

• Ethiopia continues to improve its already high level of debt transparency. Since September 2018, authorities have regularly published quarterly statistical reports providing detailed coverage of SOE debt and an annual report on debt portfolio management.

• The citizenry is enjoying a higher degree of freedom and engagement, including from the introduction of the Civil Society Organizations (CSO) Proclamation, which has allowed CSOs to start working in areas relating to advocacy, human rights, and democracy. CSOs have also been

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9 Officially announced at: https://www.ethiotelecom.et/tariff-reduction-september-2018/.

10 Total FDI under the two solar PPPs is expected to be about US$250 million. The abovementioned transactions were initially framed as part of the Scaling Solar Program standardized approach, under which foreign exchange convertibility and transferability is a critical aspect of the risk allocation it enables. However, in face of competing demands on forex, the Government decided to adhere to the existing NBE directive which does not allow for a government guarantee of foreign exchange convertibility and transferability. As a result, the PPP was not marketed as a Scaling Solar transaction.
increasingly involved in consultations around the new Media and Access to Information proclamations (currently under preparation).

9. **This second operation is expected to contribute to the deepening of key structural reforms, while it also introduces measures aimed at removing constraints to access to credit by the private sector and improving macroeconomic management.** The proposed operation is structured around three strategic pillars: (i) maximizing finance for development; (ii) improving the investment climate and developing the financial sector; and (iii) enhancing transparency and accountability. The Government has made good progress in these areas over the last year, and the prior actions proposed for this operation are consistent with the triggers identified in the first operation, or in several cases, represent a strengthening of the program relative to what was planned a year ago. In a few cases (proclamations on competition and public enterprises, CSO regulation), progress has been slower than expected, usually to allow further consultation (see Table 4).

- Actions to maximize finance for development include: (1) promoting PPPs; (2) improving efficiency and restoring financial sustainability in the power sector; (3) introducing competition and foreign participation in the logistics sector to reduce costs and improve efficiency; and (4) introducing competition and foreign participation in the telecom sector to improve connectivity.

- Actions to improve the investment climate and develop the financial sector include: (5) opening economic sectors to foreign participation and updating the legal framework for investment and competition to foster private sector development; (6) removing constraints to access to credit in the private sector; and (7) establishing the government securities market.

- Actions to enhance transparency and accountability include: (8) promoting citizen engagement and social accountability and (9) improving SOE management, transparency, and accountability.

2. **MACROECONOMIC POLICY FRAMEWORK**

2.1. **RECENT ECONOMIC DEVELOPMENTS**

10. **Growth in Ethiopia continues to be robust, despite signs of deceleration.** Crop production, which amounts to one-third of GDP, slowed down respect to the previous year, against a backdrop of challenges in the supply of fertilizer and other agricultural inputs. With low water levels for hydropower generation, electricity production increased by just 0.4 percent in FY19 compared to double-digit growth in previous years, affecting industry performance. Cement production is estimated to have declined during the fiscal year, which points to weaker construction activity. These signs of economic deceleration are in stark contrast with estimates by authorities that real GDP grew by 9 percent in FY19, driven by a strong performance in the services sector (Table 1).^12^

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^11^ The new Investment Proclamation is expected to “de facto” allow foreign participation in the form of joint venture in the areas of energy transmission and distribution and in professional services. Education, health, some transportation sub-sectors, and cement production, among others, are expected to become fully opened for FDI.

^12^ This is consistent with some evidence that GDP growth may have been overstated in previous years as well, but not by enough
11. **Driven by declining imports, the current account deficit narrowed in FY19, as public investment remained constrained.** Growth in exports of goods and services eased to an estimate of 7.9 percent in FY19. Continuing a downward trend, merchandise exports fell by 6.2 percent, driven by declines in coffee and oil seed exports which were dragged by low global commodity prices, an increase in illicit trade activities, and an overvalued exchange rate. Electronics experienced an 11.4 percent decline, falling to 1.2 percent of total exports. In contrast, garment exports performed strongly, increasing by 47 percent (albeit from a low base), boosting their contribution to total exports from 3.5 to 5.8 percent. Service exports and imports increased by 17.7 and 24 percent, respectively, driven by strong activity in Ethiopian Airlines. Meanwhile, merchandise imports declined by 1 percent as a result of the restraint on public investments and the persistent foreign exchange shortages. The compression of goods imports coupled with large official inflows played a significant role in the narrowing of the current account deficit in FY19. The current account deficit was largely financed through FDI—which declined from 4.4 percent of GDP in FY18 to 3.1 percent in FY19—and official loans. Gross international reserves increased to US$3.4 billion in June 2019, compared to US$2.8 billion in June 2018, supported by large deposits by Abu Dhabi and disbursements from the World Bank’s first DPF operation, but remain low by international standards.

12. **The pace of nominal depreciation accelerated in late 2019 to address imbalances and foreign exchange shortages.** After keeping the exchange rate largely constant in FY18 following the October 2017 devaluation of 15 percent, the NBE allowed the birr to depreciate by about 6 percent against the U.S. dollar in FY19. Nonetheless, the real effective exchange rate resumed its trend of appreciation due to the inflation differential with trading partners, thus penalizing exporters. In addition, foreign currency shortages intensified in recent months, and the parallel market premium has risen above 40 percent, fueled by continued real currency overvaluation. With a view of gradually addressing misalignments, between mid-November and mid-December, authorities accelerated the pace of depreciation more than tenfold, with the birr depreciating by about 10 percent during the first half of FY20.

13. **While monetary policy was tighter in FY19, Ethiopia continued to experience double-digit inflation.** Reserve money growth eased from 19.1 percent in June 2018 to 15.3 percent in June 2019, leading to a slowdown in broad money growth. Credit to SOEs and to the government slowed down significantly in FY19, while growth in private sector credit increased to 36.1 percent as authorities lifted the limit on private banks’ outstanding lending that had been imposed to mitigate the inflationary impact of the October 2017 devaluation. Overall, the monetary stance adopted has been insufficient to contain inflation, which soared to 19.5 percent as of December 2019, driven by high food inflation amid poorer agriculture performance and supply constraints (including delays in wheat imports and interruptions in domestic logistics). Bread, cereals, and vegetables, with a combined weight of about one-third of the CPI basket, experienced double-digit price increases. Non-food inflation also reached double digits in recent months.

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to materially change the assessment of the country’s development path. As noted in the latest IMF Article IV, data source issues affect the quality of GDP measurement.
Table 1. Ethiopia Key Macroeconomic Indicators, FY 2016 - 2022

<table>
<thead>
<tr>
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<td><strong>Real Economy:</strong></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>GDP (nominal, local currency)</td>
<td>18.2</td>
<td>17.4</td>
<td>22.5</td>
<td>19.4</td>
<td>22.4</td>
<td>16.0</td>
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<tr>
<td>Real GDP</td>
<td>8.0</td>
<td>10.2</td>
<td>7.7</td>
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<td>6.3</td>
<td>6.4</td>
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<td>GDP per capita (real, US$)</td>
<td>5.3</td>
<td>7.3</td>
<td>5.3</td>
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<td>3.8</td>
<td>4.0</td>
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<td><strong>Contributions to Real GDP Growth:</strong></td>
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<td>Consumption</td>
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<td>5.0</td>
<td>3.8</td>
<td>3.9</td>
<td>5.4</td>
<td>4.5</td>
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<tr>
<td>Gross fixed investment</td>
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<td>3.6</td>
<td>3.8</td>
<td>1.7</td>
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<tr>
<td>Net export</td>
<td>-0.8</td>
<td>2.7</td>
<td>0.6</td>
<td>1.3</td>
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<td>Unemployment rate (ILO definition)</td>
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<td>1.7</td>
<td>1.9</td>
<td>1.6</td>
<td>1.3</td>
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<tr>
<td>GDP deflator</td>
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<td>6.7</td>
<td>13.5</td>
<td>11.5</td>
<td>19.4</td>
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<td>8.8</td>
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<tr>
<td>CPI (year-average)</td>
<td>9.7</td>
<td>7.3</td>
<td>14.6</td>
<td>12.5</td>
<td>19.4</td>
<td>11.1</td>
<td>8.1</td>
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<td><strong>Fiscal Accounts:</strong></td>
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<tr>
<td>Expenditures</td>
<td>17.6</td>
<td>18.1</td>
<td>15.9</td>
<td>15.4</td>
<td>15.2</td>
<td>16.0</td>
<td>16.7</td>
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<td>Revenues</td>
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<td>14.8</td>
<td>13.0</td>
<td>12.9</td>
<td>12.7</td>
<td>13.8</td>
<td>14.8</td>
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<tr>
<td>General government balance</td>
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<td>-3.3</td>
<td>-2.9</td>
<td>-2.5</td>
<td>-2.5</td>
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<td>General government debt</td>
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<tr>
<td>Base money</td>
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<td>19.1</td>
<td>15.3</td>
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<tr>
<td>Credit to non-government</td>
<td>22.1</td>
<td>23.3</td>
<td>25.1</td>
<td>25.1</td>
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<tr>
<td>Interest (key policy interest rate)</td>
<td>5.0</td>
<td>5.0</td>
<td>7.0</td>
<td>7.0</td>
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<td><strong>Balance of Payments:</strong></td>
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<tr>
<td>Current account balance</td>
<td>-9.9</td>
<td>-8.2</td>
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<td>-4.5</td>
<td>-5.5</td>
<td>-4.3</td>
<td>-4.2</td>
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<td>Imports, goods and services</td>
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<td>25.4</td>
<td>24.5</td>
<td>20.6</td>
<td>21.3</td>
<td>23.3</td>
<td>25.5</td>
</tr>
<tr>
<td>Exports, goods and services</td>
<td>8.4</td>
<td>8.8</td>
<td>9.4</td>
<td>7.9</td>
<td>8.1</td>
<td>8.9</td>
<td>10.0</td>
</tr>
<tr>
<td>Foreign Direct Investment</td>
<td>4.1</td>
<td>5.1</td>
<td>4.4</td>
<td>3.1</td>
<td>3.6</td>
<td>4.1</td>
<td>4.4</td>
</tr>
<tr>
<td>Gross Reserves (eop., in US$ million)</td>
<td>3,402</td>
<td>3,197</td>
<td>2,847</td>
<td>3,415</td>
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<tr>
<td>Terms of Trade (growth rate)</td>
<td>1.6</td>
<td>-3.1</td>
<td>-1.7</td>
<td>-2.6</td>
<td>-2.6</td>
<td>-2.2</td>
<td>-1.7</td>
</tr>
<tr>
<td>Exchange Rate (per US$, average)</td>
<td>21.1</td>
<td>22.4</td>
<td>26.1</td>
<td>27.7</td>
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<td></td>
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<td><strong>Other Memo Items:</strong></td>
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<tr>
<td>GDP (nominal, US$ million)</td>
<td>72,702</td>
<td>80,355</td>
<td>82,231</td>
<td>94,088</td>
<td>102,947</td>
<td>113,897</td>
<td>122,887</td>
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</table>

*Source:* NBE, PDC, Ministry of Finance (MoF), World Bank estimates.
14. Despite continuing poor revenue performance, the fiscal deficit was brought below 3 percent of GDP in FY19 as authorities curbed expenditure. Revenue mobilization continued to disappoint in FY19, with tax revenue collection declining to 10 percent of GDP compared to 10.7 percent in FY18 (Table 2). This poor performance can be explained by weak tax administration, a drop in foreign trade tax revenue related to lower imports, and delays in implementing policy measures to increase tax revenues. Contained expenditures as a share of GDP and an increase in grant receipts compensated for the lower-than-expected revenue collection. The fiscal deficit was financed partly through concessional external borrowing (40 percent) and partly through domestic borrowing (60 percent), including direct financing from the NBE amounting to 1.4 percent of GDP.

Table 2. Ethiopia Key Fiscal Indicators, FY 2016 - 2022

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<tr>
<td>Overall balance</td>
<td>-2.3</td>
<td>-3.3</td>
<td>-2.9</td>
<td>-2.5</td>
<td>-2.5</td>
<td>-2.2</td>
<td>-1.9</td>
</tr>
<tr>
<td>Primary balance</td>
<td>-1.9</td>
<td>-2.9</td>
<td>-2.4</td>
<td>-1.9</td>
<td>-1.9</td>
<td>-1.5</td>
<td>-1.3</td>
</tr>
<tr>
<td>Total revenues and grants</td>
<td>15.3</td>
<td>14.8</td>
<td>13.0</td>
<td>12.9</td>
<td>12.7</td>
<td>13.8</td>
<td>14.8</td>
</tr>
<tr>
<td>Tax revenues</td>
<td>11.9</td>
<td>14.8</td>
<td>13.0</td>
<td>12.9</td>
<td>12.7</td>
<td>13.8</td>
<td>14.8</td>
</tr>
<tr>
<td>Taxes on goods &amp; serv.</td>
<td>3.6</td>
<td>3.5</td>
<td>3.1</td>
<td>3.1</td>
<td>3.3</td>
<td>3.9</td>
<td>4.9</td>
</tr>
<tr>
<td>Direct taxes</td>
<td>4.4</td>
<td>4.4</td>
<td>4.4</td>
<td>4.2</td>
<td>4.2</td>
<td>4.4</td>
<td>4.4</td>
</tr>
<tr>
<td>Taxes on int. trade</td>
<td>3.9</td>
<td>3.6</td>
<td>3.2</td>
<td>2.8</td>
<td>3.0</td>
<td>3.2</td>
<td>3.4</td>
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<tr>
<td>Non-tax revenues</td>
<td>2.5</td>
<td>2.6</td>
<td>1.6</td>
<td>1.7</td>
<td>1.5</td>
<td>1.5</td>
<td>1.5</td>
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<tr>
<td>Grants</td>
<td>0.8</td>
<td>0.7</td>
<td>0.8</td>
<td>1.2</td>
<td>0.9</td>
<td>0.8</td>
<td>0.6</td>
</tr>
<tr>
<td>Expenditures</td>
<td>17.6</td>
<td>18.1</td>
<td>15.9</td>
<td>15.4</td>
<td>15.2</td>
<td>16.0</td>
<td>16.7</td>
</tr>
<tr>
<td>Current expenditures</td>
<td>8.2</td>
<td>8.9</td>
<td>9.2</td>
<td>8.8</td>
<td>8.8</td>
<td>9.0</td>
<td>8.9</td>
</tr>
<tr>
<td>Wages &amp; compensation</td>
<td>7.7</td>
<td>8.5</td>
<td>8.7</td>
<td>8.2</td>
<td>8.3</td>
<td>8.3</td>
<td>8.3</td>
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<tr>
<td>Interest payments</td>
<td>0.5</td>
<td>0.4</td>
<td>0.5</td>
<td>0.6</td>
<td>0.6</td>
<td>0.8</td>
<td>0.9</td>
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<tr>
<td>Capital expenditures</td>
<td>8.9</td>
<td>8.3</td>
<td>6.4</td>
<td>6.5</td>
<td>6.3</td>
<td>6.9</td>
<td>7.7</td>
</tr>
<tr>
<td>Government financing</td>
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<td>-3.3</td>
<td>-2.9</td>
<td>-2.5</td>
<td>-2.5</td>
<td>-2.2</td>
<td>-1.9</td>
</tr>
<tr>
<td>External (net)</td>
<td>0.7</td>
<td>1.6</td>
<td>1.2</td>
<td>1.1</td>
<td>1.2</td>
<td>1.2</td>
<td>1.7</td>
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<tr>
<td>Domestic (net)</td>
<td>1.6</td>
<td>1.7</td>
<td>1.7</td>
<td>1.4</td>
<td>1.3</td>
<td>1.0</td>
<td>0.2</td>
</tr>
<tr>
<td>of which: privatization</td>
<td>0.0</td>
<td>0.6</td>
<td>0.4</td>
<td>0.0</td>
<td>0.5</td>
<td>0.5</td>
<td>0.4</td>
</tr>
<tr>
<td>GDP (nominal, local currency millions)</td>
<td>1,534,447</td>
<td>1,801,055</td>
<td>2,205,689</td>
<td>2,680,208</td>
<td>3,401,779</td>
<td>4,064,690</td>
<td>4,736,372</td>
</tr>
</tbody>
</table>

Source: MoF.

15. The pickup in urban unemployment rates, in combination with double-digit inflation, has likely negatively affect urban poverty. Following a decade of secular decline, the urban unemployment rate increased from 17 percent in 2016 to 19 percent in 2018, with a larger increase for youth (from 22 percent
in 2016 to 25 percent in 2018). At the same time, double-digit inflation has eroded the purchasing power of urban low-income households. In rural areas, agricultural growth has rebounded from the 2015/16 drought and grain output per holder has surpassed its pre-drought level. In addition, high food prices have traditionally helped rural poverty reduction in Ethiopia.

### 2.2. MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

16. **Macroeconomic measures under the recently announced Homegrown Reform Agenda are expected to result in slower growth during the next two years, while improving the medium-term outlook.** As abovementioned, the more prudent policy stand introduced during FY19 has been insufficient to curb inflation and foreign exchange shortages. Thus, further easing in the pace of money growth and the phasing out of NBE funding of the government and SOEs is needed. Concerted reforms, supported by this DPF series and a recently approved International Monetary Fund (IMF) program, entail a commitment to prudent monetary and fiscal policies, as well as stronger oversight over SOE activities to help correct macroeconomic imbalances.\(^{13}\) While growth is likely to be slower in the near term as a result, reforms will set the foundations for a more balanced and stronger economy in the future. The structural policies approved by the Government and supported by this DPF series, together with significant improvements in the business environment, are expected to have growth-enhancing effects on the private sector. Particularly, exports are expected to regain momentum as imbalances addressed and logistics and business environment reforms are introduced, and private investment is expected to be fueled by the new investment and privatization proclamations and the repeal of the 27 percent rule.

17. **Estimates on the potential impact of reforms have been incorporated to this outlook.** The forecasts discussed in this section consider the estimated effects of economic reforms directly supported by the prior actions in this DPF series (Box 1), as well as other reforms that are part of the IMF program (e.g., a faster depreciation rate, excise tax reform, etc.). These projections are conservative with respect to an increase in FDI inflows that might result from the opening of key sectors to foreign investment.

**Box 1: Estimating the Macroeconomic Impact of Reforms**

This Box presents estimates of the reforms supported under this Second Ethiopia Growth and Competitiveness Programmatic DPF (DPF2) that have a direct fiscal or monetary impact. These include energy debt restructuring (DPF2 Prior Action #3), the repeal of the 27 percent rule (DPF2 Prior Action #7),\(^{14}\) and the introduction of T-bill auctions (DPF2 Prior Action #8).

The restructuring of part of EEP’s domestic debt involves converting MoF’s outstanding on-lent loans to EEP (above 10 percent of EEP’s domestic debt) into MoF’s equity, as well as taking over obligations equivalent to 20 percent of EEP’s debt to the Commercial Bank of Ethiopia. The conversion of the on-lent loans into equity is not expected to have any impact on the fiscal accounts of MoF, as EEP has not been servicing these loans and the debt service receipts have not been considered for revenue planning.

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\(^{13}\) The main objectives of the IMF program are to address external imbalances, including real exchange rate overvaluation, reduce debt vulnerabilities by undertaking consolidation of the broader public sector while increasing social spending, tighten monetary conditions to reduce inflation, and implement structural reforms to encourage private sector-led growth. This macroeconomic outlook refers to some of the specific policy actions.

\(^{14}\) Private banks are required to buy five-year NBE Bonds equivalent to 27 percent of all loans disbursed, the proceeds of which largely go to fund the DBE and reduce liquidity in private commercial banks.
purposes. The taking over of part of EEP’s debt service obligations, however, will increase the governments’ expenditures via increased debt service, starting in FY21. A technical working group is currently engaged in discussions regarding the implementation of this decision.

The government has also started to issue T-bills at auction-determined rates with the participation from private banks. The volume of T-bills to be issued in FY20 is expected to be ETB 6 billion, according to the Government plan. Going forward, the analysis assumed that authorities will increase issued amounts in each of the subsequent fiscal years. The issuing of T-bills at competitive rates entails additional interest expenditure by the government and will be coupled with reduction of direct advances from the NBE to the MoF, which will affect reserve money, the operating target of the NBE. In the long term, this action will contribute to the development of the domestic debt market, helping improving access to finance at different maturities for both government and the private sector.

Effective November 2019, the NBE has repealed the 27 Percent Rule that required private commercial banks to acquire central bank bonds whenever they lent to customers. This measure will release additional liquidity to the private banks to purchase T-bills and increase financing to the private sector.

*Fiscal impacts*

As a result of the takeover of part of EEP’s debt service obligations, government expenditures are expected to increase by about 0.2 percent of GDP per year on average during FY21-24. Similarly, the additional interest expense of issuing T-bills at competitive rates is expected to amount to 0.1 percent of GDP on an annual basis. Thus, the fiscal impact of these measures is estimated to be an increase of about 0.3 percent of GDP in the fiscal deficit on an annual basis. This impact is expected to be partly offset by new revenue mobilization measures (e.g., the new excise tax proclamation) as well as receipts from privatization. The issuance of new licenses in the telecom sector, not yet incorporated into the projections, is expected to yield billions of dollars against a backdrop of intense competition among international telecom operators.

*Monetary impacts*

The reduction of direct advances from the NBE is expected to lower the growth in reserve money, while the repeal of the 27 Percent Rule is estimated to result in a release of liquidity. For the purposes of measuring the impact of this reform, it is assumed that the NBE does not conduct liquidity-mopping operations following the removal of the 27 Percent Rule. In such a scenario, private sector credit growth would reach 21.7 percent in FY20, compared to 15.8 percent in a non-reform scenario. This would translate into an annual increase of 1 percentage point, on average, in broad money supply (M2).

18. **Inflation is projected to remain in double digits in FY20, prior to easing in the medium term.** To address elevated domestic inflation, authorities intend to restrict the growth of reserve money to 12.5 percent. Towards this end, as envisaged in the IMF program, the NBE phases out direct advances to the Government and ends financing of the DBE. The NBE has also started to introduce deposit auctions at market-determined rates as a new policy instrument. Furthermore, the introduction of indirect instruments such as the new market-based T-bills supported under this operation is expected to support monetary consolidation. Tighter monetary policy will be key to soothe inflationary pressures, although it may impact with a lag. Meanwhile, the removal of the 27 Percent Rule, coupled with the expected scaling-back of lending to SOEs, is expected to allow the private sector to continue enjoying healthy credit growth.

19. **Reforms supported by the IMF program, together with the injection of funding by development partners, are expected to reduce the foreign exchange shortage; this would need to be complemented**

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15 In the estimation of impacts, a 7 percent interest rate on the new publicly auctioned T-bills is assumed, higher than the fixed rate in existing government securities (between 0.63 and 1.2 percent) and similar to the interest rate paid on deposits.
with the phasing out of foreign exchange restrictions. Addressing real currency overvaluation, coupled with business environment reforms supported under this DPF series plus some key investments, would contribute to a recovery of exports, which would improve foreign exchange availability and reduce risk of external debt distress. Following the FY19 dip to 3.1 percent of GDP, FDI inflows are expected to mildly recover, averaging 3.8 percent in the coming years (Table 1); these are conservative estimates that do not include potential FDI into privatized SOEs; furthermore, the upside potential for additional FDI inflows is large, considering the planned award of the 17 PPP projects in the pipeline in the coming two years, as well as the expected receipts from the issuance of the new telecom licenses. The phasing out of the current foreign exchange management system and a gradual move toward more flexible foreign exchange management and a market-determined exchange rate are desirable measures whose implementation may commence once the current critical shortage of foreign exchange as well as other imbalances have been addressed.

20. **The fiscal stance is expected to remain prudent.** The fiscal deficit is expected to decrease from 2.5 percent of GDP to below 2 percent by FY22. Improvements in revenue collection stemming from a new excise tax, together with a reduction in tax exemptions and progressive strengthening of tax administration, will help compensate for increasing debt service payments and capital spending. The reduction of exempt categories in the second schedule of customs duties in 2019 could render increased trade tax collection in the short run, while tariffs are expected to decline in the medium term as the Government has resumed negotiations for WTO accession after seven years and has ratified the African Continental free Trade Agreement. On the expenditure side, authorities are expected to review and rationalize existing subsidies, while expanding social assistance spending and safety nets. SOE borrowing needs are expected to decline as a result of energy tariff increases and controlled growth in capital spending. The Government plans to finalize ongoing infrastructure projects, while future infrastructure and energy investment needs would need to be critically assessed and would have to be financed primarily through concessional loans or alternative mechanisms such as PPPs and direct private participation. The ongoing reform of SOEs (including privatization) and limits to SOE borrowing under the approved IMF program are intended to contain outlays.

21. **Ethiopia’s external financing requirements are projected to stabilize, allowing for a gradual build-up of foreign exchange reserves, partly thanks to the gains from debt reprofiling** (Table 3). Weak export performance coupled with the maturation of non-concessional loans contracted in the last five years caused debt sustainability indicators to deteriorate, placing the economy at high risk of external debt distress since 2017 (see Annex 5 on Debt Sustainability Analysis). The adoption of the Public Debt Management and Guarantee Issuance Directive (No 46/2017) in January 2017 has enabled the

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16 The Addis Ababa–Djibouti Railway, which will improve trade logistics and reduce transportation costs for imports and exports, is partially operational and is expected to be completed within the next two years. The addition of two industrial parks, Adama and Jimma, in FY19 is also expected to help underpin manufacturing export performance. The power lines linking to neighboring Kenya are expected to be ready to export electricity by April 2020. Moreover, the IFC is supporting import-substitution investments in the agriculture and manufacturing sectors.

17 The new excise tax proclamation has introduced new excisable goods and services and revised the rates on the preexisting excisable items; it also changed the excise tax base estimation from cost of production to sales, which is expected to make its administration more efficient.
Government to exercise much stricter control on non-concessional borrowings of SOEs. Other response measures adopted by the Government include observing a zero limit on non-concessional borrowing and reprofiling of a significant part of non-concessional debt in early FY20. Agreed reprofiling is expected generate savings above 600 hundred millions a year during FY21 and FY22. However, it may not be enough to achieving a “moderate” risk of external debt distress rating by 2022. Additional reprofiling of non-concessional borrowing and appropriate burden sharing among creditors is needed, especially in the light of the World Bank’s highly concessional support, with the financing terms of IDA18 commitments being fifty percent grant and fifty percent credit.

22. The Government has been taking measures to further enhance transparency in debt management in what is already considered to be a strong debt reporting system. The identification and monitoring of contingent liabilities will be critical to ensuring debt sustainability. The restructuring of the Government’s executive arrangements in October 2018 that placed the former Ministry of Public Enterprises under the MoF as a Public Enterprises Holding and Administration Agency (PEHAA) has enhanced the MoF’s monitoring of SOEs’ activities, including their borrowings (DPF2 Prior Action #10). Authorities continue to improve the monitoring of its external and domestic debt and have launched regular quarterly publication of the Public Sector Debt Statistical Bulletin as well as an annual Public Debt Portfolio Review report that includes SOE debt. More detailed coverage is planned for future reports, including disaggregation of debt by SOEs, additional information about on-lent loans, and cost and risk indicators. It is also worth noting that SOE borrowing—both domestic and external—often involves a sovereign guarantee, exposing the government to contingent liabilities if the SOEs are unable to service their debts. The projected public debt path is susceptible to the materialization of contingent liabilities. In this regard, the World Bank has initiated a capacity building program to help identify and mitigate fiscal risks arising from both PPPs and SOEs. Moreover, the planned Asset Quality Review of the CBE is expected to contribute to the identification of contingent liabilities.

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18 Ethiopia has also established a comprehensive legal framework for debt management that ranks among the best worldwide in the World Bank’s Debt Management Performance Assessment (DeMPA), 2013.

19 The authorities have concluded an agreement with creditors to restructure loans extended to the railway, sugar, and electricity sectors, amounting to about US$4.5 billion (15 percent of total external debt). Agreement with Gulf countries on the reprofiling of deposits to NBE was reached in December 2019.
Table 3. Ethiopia - Balance of Payments Financing Requirements and Sources, FY 2016-2022

<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td><strong>Financing requirements (in US$ million)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current account deficit</td>
<td>8,286.3</td>
<td>7,526.8</td>
<td>6,633.5</td>
<td>5,710.0</td>
<td>7,294.1</td>
<td>6,198.3</td>
<td>6,057.3</td>
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<tr>
<td>Short term debt amortizations</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Long term debt amortization (excl. IMF)</td>
<td>7,335.3</td>
<td>6,528.4</td>
<td>5,502.3</td>
<td>4,305.5</td>
<td>5,962.0</td>
<td>4,810.0</td>
<td>4,742.0</td>
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<tr>
<td>Multilateral</td>
<td>101.8</td>
<td>97.8</td>
<td>122.5</td>
<td>88.0</td>
<td>90.0</td>
<td>120.8</td>
<td>156.9</td>
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<tr>
<td>Bilateral</td>
<td>169.5</td>
<td>204.0</td>
<td>98.6</td>
<td>477.0</td>
<td>248.4</td>
<td>180.4</td>
<td>196.0</td>
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<tr>
<td>Paris Club</td>
<td>19.8</td>
<td>24.7</td>
<td>23.8</td>
<td>28.3</td>
<td>21.9</td>
<td>21.9</td>
<td>22.1</td>
</tr>
<tr>
<td>Non-Paris Club</td>
<td>149.7</td>
<td>179.3</td>
<td>74.8</td>
<td>448.7</td>
<td>226.4</td>
<td>158.5</td>
<td>173.9</td>
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<tr>
<td>Commercial</td>
<td>679.7</td>
<td>696.5</td>
<td>910.1</td>
<td>839.5</td>
<td>993.7</td>
<td>1,087.1</td>
<td>962.3</td>
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<tr>
<td>Other short-term capital outflows</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
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<tr>
<td><strong>Financing Sources (US$ million)</strong></td>
<td>9,261.9</td>
<td>6,971.1</td>
<td>6,616.2</td>
<td>6,628.1</td>
<td>7,356.4</td>
<td>7,034.8</td>
<td>6,846.3</td>
</tr>
<tr>
<td>Foreign direct investment (net)</td>
<td>3,028.2</td>
<td>4,170.8</td>
<td>3,723.4</td>
<td>3,015.4</td>
<td>4,086.0</td>
<td>3,949.0</td>
<td>3,704.0</td>
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<tr>
<td>Other flows (net)</td>
<td>1,709.1</td>
<td>-577.1</td>
<td>-612.7</td>
<td>-691.7</td>
<td>1,297.8</td>
<td>1,043.8</td>
<td>674.8</td>
</tr>
<tr>
<td>o/w Debt service reprofiling</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>156.0</td>
<td>634.0</td>
<td>638.0</td>
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<tr>
<td>Capital grants</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Short term debt disbursements</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Long-term debt disbursements (excl. IMF)</td>
<td>4,524.6</td>
<td>3,377.4</td>
<td>3,505.4</td>
<td>4,304.4</td>
<td>1,972.6</td>
<td>2,042.0</td>
<td>2,467.4</td>
</tr>
<tr>
<td>Multilateral</td>
<td>1,382.4</td>
<td>1,513.5</td>
<td>1,424.0</td>
<td>1,440.8</td>
<td>1,268.6</td>
<td>1,403.0</td>
<td>1,991.0</td>
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<tr>
<td>Bilateral</td>
<td>2,698.0</td>
<td>944.8</td>
<td>706.8</td>
<td>1,901.9</td>
<td>282.7</td>
<td>301.8</td>
<td>246.0</td>
</tr>
<tr>
<td>Paris Club</td>
<td>73.0</td>
<td>61.1</td>
<td>47.9</td>
<td>61.5</td>
<td>45.3</td>
<td>75.8</td>
<td>79.9</td>
</tr>
<tr>
<td>Non-Paris Club</td>
<td>2,624.9</td>
<td>883.7</td>
<td>659.0</td>
<td>1,840.4</td>
<td>237.4</td>
<td>226.0</td>
<td>166.0</td>
</tr>
<tr>
<td>Commercial</td>
<td>444.2</td>
<td>919.2</td>
<td>1,374.6</td>
<td>961.8</td>
<td>421.2</td>
<td>337.2</td>
<td>230.5</td>
</tr>
<tr>
<td><strong>Change in reserves</strong></td>
<td>-975.6</td>
<td>597.1</td>
<td>70.8</td>
<td>-866.0</td>
<td>649.3</td>
<td>1,635.5</td>
<td>1,780.0</td>
</tr>
<tr>
<td>IMF credit (net)</td>
<td>-41.4</td>
<td>-53.4</td>
<td>-52.1</td>
<td>587.0</td>
<td>799.0</td>
<td>991.0</td>
<td></td>
</tr>
</tbody>
</table>

Source: NBE, MoF, and World Bank estimates.

23. Ethiopia’s recent achievements notwithstanding, future growth and further gains in poverty reduction and shared prosperity are subject to significant downside risks. A change in the political situation could prevent or reverse reforms. In such a scenario, Ethiopia’s reliance on public sector demand (especially SOE investment) and financial repression, if continued to the same extent, could constrain the growth of investment yields and productivity, while economic imbalances would worsen further. Another potential source of risk is macro-financial instability originating from continued loose management in the broader public sector (SOEs), which could lead to fiscal slippages and further expose the Commercial Bank of Ethiopia (CBE). Faster depreciation would lead to mild negative welfare effects across the distribution through higher energy, housing and clothing prices, while households engaged in agricultural activities would be shielded. Failure of the economic reforms to deliver tangible benefits could undermine...
government support ahead of the general elections, planned on August, and add to the political risks. Two of the main credit rating agencies assigned Ethiopia a single B rating and one a B+ rating, as the country’s obligations are subject to high credit risk. In September 2019, Moody’s changed its outlook to negative, considering the decline in government revenue generation and persistent SOE external debt. However, there is also upside potential—if implemented as planned, the reforms in this series represent a significant change in Ethiopia’s development strategy that could sustain already high growth to middle-income status and beyond.

24. While risks remain elevated, the macroeconomic policy framework is adequate for the proposed operation. In part this is due to a consistent package of macroeconomic policies supported by the IMF to gradually address imbalances, complemented with a strong set of structural reforms to support growth under this DPF. To summarize, the Government has already taken significant steps to deal with the country’s elevated risk of debt distress. It has curbed non-concessional borrowing, and it has committed to prudent fiscal and monetary management and to addressing foreign exchange shortages. The reforms supported by this DPF series will complement prudent macroeconomic policies with measures to foster private sector-led development and growth. The adoption of new investment and competition proclamations is expected to further boost the country’s attractiveness for private capital. When fully implemented, the steps taken by the Government to accelerate reform of SOEs to improve governance, management, accountability, and financial performance will help strengthen the overall financial sustainability of the economy.

2.3. IMF RELATIONS

25. On December 20, 2019, the IMF Board approved US$2.9 billion program to support Ethiopia’s Homegrown Reform Program under exceptional access. An IMF Article IV and program preparation mission took place during October 29-November 8, 2019. World Bank staff have been involved in discussions with authorities on recent economic developments and the outlook, as well as in preparation of the new joint Debt Sustainability Analysis. These discussions have helped inform the macroeconomic framework proposed in this DPF2 and ensure consistency of the prior actions with the IMF program, which aims at: durably addressing the foreign exchange shortage by eliminating real overvaluation over the course of the program; reducing the fiscal deficit by strengthening revenue mobilization and consolidating expenditure (including by SOEs); increasing government financing through market-based instruments; and removing distortions in the flow of credit to the private sector.

26. Staff from the IMF and World Bank collaborate closely to monitor macroeconomic development and analyze policy reforms in Ethiopia. Regular bilateral meetings are held to exchange information and coordinate activities. Joint recommendations by the World Bank and IMF staff include: (i) promoting a more flexible exchange rate to enhance competitiveness and foster export diversification, (ii) developing a broader range of indirect monetary policy instruments, (iii) promoting an active interbank market, (iv) strengthening domestic revenue mobilization and accelerating tax administration reform, (v) strengthening the legal framework for PPPs, (vi) improving the business climate, (vii) promoting financial inclusion, (viii) improving economic governance, and (ix) closely monitoring the non-performing loan (NPL) ratios of public banks.
3. GOVERNMENT PROGRAM

27. The Government’s economic program is defined in the 2016-2020 GTP II, which aims to enable Ethiopia to achieve lower middle-income status by 2025. The strategy advances reform efforts launched under the GTP I, which focused on boosting agricultural productivity and accelerating growth through large-scale public investment in infrastructure. The GTP II emphasizes the need to maintain the high economic growth rates achieved under the GTP I, but it shifts focus to expanding the role of the private sector. The strategy also calls for increasing domestic revenue mobilization through tax reform, exploring alternative mechanisms for financing infrastructure, and strengthening economic governance. The GTP II is designed around four development objectives: (i) achieve an average annual real GDP growth rate of 11 percent in a context of macroeconomic stability; (ii) boost the competitiveness of the domestic economy and facilitate structural transformation; (iii) promote organized public participation in development policy and enhance public ownership of development outcomes, and (iv) ensure stable democratic processes.

28. The GTP II has recently been complemented by the Homegrown Reform Agenda. As described earlier, the Homegrown Reform Agenda complements ongoing structural reforms aimed at easing business constraints with macroeconomic measures, as well as a series of sectoral reforms. The reform package is expected to help rebalance growth and productivity and build confidence, ultimately leading to inclusive development, jobs, and poverty reduction. DPF2 is fully aligned with this Homegrown Reform Agenda in providing support to structural reforms (Pillars 2 and 3), implementation of macro-financial measures (Pillar 2), and sector-specific policies (Pillar 1), as presented in more detail in the next section.

4. PROPOSED OPERATION

4.1. LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

29. This DPF series directly supports the Government’s program, with a focus on maximizing finance for development, expanding the economic role of the private sector, and promoting transparency and accountability. The proposed budget support complements ongoing WBG engagement in Ethiopia in support of the GTP II, a US$11.94 billion portfolio that includes 38 active operations and 41 advisory services and analysis covering areas such as agriculture and rural development, urban development, infrastructure, industrialization, climate resilience, social protection, health, education, good governance, finance, and digital development. Against this backdrop, and in response to a request from the Government, this DPF series aims to help boost economic transformation by increasing private sector participation and promoting good governance practices. Reflecting key lessons learned from the World Bank’s extensive experience in preparing DPFs, the following interdependent filters were applied to guide the choice of objectives and prior actions for this DPF series: (i) the relative urgency of reforms; (ii) the presence of strong analytical underpinnings and a good knowledge base to inform the choice of actions; (iii) robust implementation arrangements; (iv) a strong government commitment to implement the reforms within the operation’s timeframe; and (v) coordination with other development partners.
30. **The prior actions selected for DPF2 build on progress made thus far in meeting the program development objectives of the DPF series.** This second operation builds on the achievements under DPF1, as summarized earlier. The policy matrix for this series (see Annex 1 for the full matrix) shows continuity across the three pillars, with several actions following up on actions under DPF1, and new actions focusing on removing constraints to access to credit by the private sector and establishing alternative sources of financing for the public sector. As of mid-December, all the prior actions proposed under the DPF2 have been completed by the Government (Table 4). Thus, on their own, reforms accomplished under the first and second DPFs already constitute an important departure from the previous economic status quo, which reduces risks of policy reversal. While some of the prior actions rely on the approval of Proclamations by the Council of Ministers, instead of by the Parliament (DPF2 Prior Actions #6, #9, and #10), Ethiopia has a positive track record in terms of enactment and implementation of legislation, as demonstrated under DPF1;\(^{20}\) in fact, two of these Proclamations were approved already by the Parliament in early 2020. This provides enough comfort that the legislation will be fully enacted well before the upcoming elections. The selected prior actions build upon related technical assistance and analytics and are not directly supported by other lending projects.

31. **The proposed operation supports a far-reaching reform program that reflects both the Government’s ambitious development goals and the WBG’s extensive and deep engagement in Ethiopia.** The policy matrix (Annex 1) has been developed through extensive dialogue, analytical work, and collaboration. Toward the preparation of this second operation in the series, the Government has regularly convened a Technical Committee for DPF2 chaired by the State Minister at the MoF and comprising government focal points from relevant agencies, World Bank team members, and development partner agencies\(^{21}\) that are expected to provide budget support linked to this operation. The implementation of government reforms is underpinned by an extensive technical assistance program involving the World Bank, International Finance Corporation (IFC), IMF, and development partners and incorporates lessons from previous DPFs. Teams have confirmed that, aside from technical assistance, the prior actions under this DPF2 are not financed by other ongoing operations.

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20 In Ethiopia, a Proclamation becomes effective (enters into force) upon publication in the Federal Negarit Gazette. According to the Office of the Attorney General, legislation is usually approved by the House of People’s Representatives within 3-4 months after submission by the Council of Ministers, and official publication is then completed within one month. Both the PPP and CSO Proclamations under DPF1 in this series have been enacted (in March and February 2019, respectively). Their final wording remains satisfactory to the World Bank teams supporting the reforms, as the House of People’s Representatives did not introduce changes that were against the spirit and objective of the draft submitted by the Council of Ministers.

21 France (Agence Française de Développement, Embassy of France), Germany (Kreditanstalt für Wiederaufbau, Deutsche Gesellschaft für Internationale Zusammenarbeit, Embassy of Germany), UK’s Department for International Development and the European Union.
### Table 4. Indicative triggers from DPF1 compared to prior actions for DPF2

<table>
<thead>
<tr>
<th>Indicative trigger for DPF 2</th>
<th>Prior action for DPF 2</th>
<th>Change</th>
<th>Current status</th>
<th>Related projects</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Pillar 1. Maximizing finance for development</strong></td>
<td><strong>Indicative Trigger #1.1: The PPP Directorate General issues PPP Implementation Guidelines with the required procedures and authorizations to undertake PPP transactions, including an assessment of the contingent liabilities related to the sovereign contractual obligations.</strong></td>
<td>Prior Action #1: The PPP Directorate General has issued PPP Implementation Guidelines with the required procedures and authorizations to undertake PPP transactions, including an assessment of the contingent liabilities related to the sovereign contractual obligations.</td>
<td>No material change. In preparation for the assessment of contingent liabilities, the World Bank is engaging with counterparts on capacity building. The team has also initiated engagement on the Environmental and Social Impact assessment and strengthened the triggers for DPF3.</td>
<td>Completed</td>
</tr>
<tr>
<td><strong>Indicative Trigger #2.1: (i) The Government’s Macroeconomic Committee has established a Power Sub-Sector Committee to oversee the development and implementation of an institutional reform roadmap in the power sector. (ii) The Ministry of Water, Irrigation and Electricity is implementing a performance improvement plan for improving operational performance in all business areas and with a focus on customer service, optimization of billing, improved collection rates, and loss reduction. (iii) Under supervision of the EEA, the EEU and EEP carry out reform measures for a second year under the tariff framework.</strong></td>
<td>Prior Action #2: (i) Under supervision of the EEA, the EEU and MoWIE have announced the implementation of a second electricity tariff increase under the multi-year electricity tariff increase framework in December 2019. <strong>Prior Action #3: The Government’s Macroeconomic Committee has approved a phased restructuring of EEP’s debt in the power sector and the Ministry of Finance has implemented a conversion of loans on-lent to EEP into equity.</strong></td>
<td>Material change. The originally proposed establishment of a Power Sub-Sector Committee has already been completed. The prior action has been strengthened by requiring the initiation of the debt restructuring for public energy utilities, originally planned for DPF3. This adds to a second year of tariff increases. The final draft of the Power Sector Roadmap (originally i and ii) is under discussion and remains a trigger in DPF3.</td>
<td>Completed</td>
<td>Ethiopia Energy Sector Review and Strategy (P146616) Ethiopia - Technical Assistance for Energy Sector Reforms (P171820)</td>
</tr>
<tr>
<td>Indicative Trigger #3.1: The EIB permits: (i) the operation of fully foreign-owned logistics providers in industrial parks and logistics clusters and (ii) the entry of foreign operators in the transportation sector through joint ventures with local logistics services providers.</td>
<td>Prior Action #4: The Government’s Macroeconomic Committee has issued a decision that encourages competition by allowing private sector, including foreign firms, to access and offer value-added logistics services in dry ports.</td>
<td>New action. The initially proposed entry of foreign operators in the transportation sector will be part of the New Investment Proclamation (Prior Action #4.1). As a further step in the opening of the logistics sector, this prior action requires that the Government allow private sector operators to access existing dry ports facilities, as well as to invest in new dry ports (strengthened requirement).</td>
<td>Completed</td>
<td>Ethiopia Trade and Logistics Project (P156590)</td>
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<tr>
<td>Indicative Trigger #4.1: The Council of Ministers approves the separation of MCIT’s telecom regulatory functions from its service delivery responsibilities.</td>
<td>Prior Action #5: (i) The Prime Minister has appointed the Board for the ECA. (ii) The ECA has convened a public consultation on the selection process for new telecom operator licenses.</td>
<td>Strengthened action (accelerated implementation). Since ECA was established by the proclamation supported under DPF1 as a regulator separated from MCIT, the new prior action required a further step: for the Board of the regulator to be appointed. In addition, public consultations on the terms of the new licenses have been required.</td>
<td>(i) Completed (ii) Completed</td>
<td>Ethiopia ICT Sector Reform ASA (P168536)</td>
</tr>
<tr>
<td>Pillar 2. Improving the investment climate and developing the financial sector</td>
<td></td>
<td>Material change. The Proclamation on Competition requires further consultation and could potentially be part of DPF3. Additional consultations will allow authorities to better reflect the inputs from different stakeholders, as well as socializing the benefits of the</td>
<td>Completed</td>
<td>Ethiopia Investment Policy and Promotion Phase II (603800) – IFC Advisory Project Ethiopia Doing Business (602819)</td>
</tr>
</tbody>
</table>

22 The decision allows private sector operators to access and offer services in existing dry ports, as well as to own and operate new dry ports.
<table>
<thead>
<tr>
<th>Indicative Trigger #6.1: (i) NBE and MoF approve an action plan to implement recommendations from CBE’s audit. (ii) NBE and MoF approve a comprehensive reform plan for the Development Bank of Ethiopia.</th>
<th>Prior Action #7: The Board of the NBE has repealed the 27 Percent Rule.</th>
<th>New action. This prior action has been strengthened relative to the indicative trigger (approval of plans), the preparation of which—supported by ongoing WB TA and a new project—needs more time. The unwinding of the 27 Percent Rule helps eliminate distortions and level the playing field for private commercial banks, which are required to surrender liquidity that is then channeled to the public sector. During the first half of 2020 the DBE is planning to undertake a strategic review exercise that will encompass identifying alternative funding sources to the proceeds from the 27 Percent Rule it used to receive.</th>
<th>Completed</th>
<th>None</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indicative Trigger #7.1: The Macroeconomic Committee: (i) endorses a market-based framework for issuing and trading government securities and (ii) implements first measures to introduce tradeable securities.</td>
<td>Prior Action #8: The Board of the NBE has approved financing through instruments at market-determined rates, and the first auction of treasury bills was conducted in December 2019.</td>
<td>No material change. The government approved the issuance of new T-bills at market-determined rates in December 2019. Six auctions have been conducted already as of early February.</td>
<td>Completed</td>
<td>Ethiopia DMF - (P170312)</td>
</tr>
</tbody>
</table>
### Pillar 3. Enhancing transparency and accountability

<table>
<thead>
<tr>
<th>Indicative Trigger #8.1: (i) The Council of Ministers approves regulations to implement the CSO Proclamation that promote greater CSO and citizen participation in the development process. (ii) The Council of Ministers submits a new Access to Information proclamation to Parliament to provide citizens with greater access to information and data held by government ministries and agencies in Ethiopia.</th>
<th>Prior Action #9: The Council of Ministers has approved for submission to Parliament a Federal Administrative Procedure Proclamation that provides for routine consultations on draft Directives, subject to specified exemption(s), and consultation is one of the pre-requisites for adoption of Directives.</th>
<th>Material change. The Access to Information Proclamation has gone through a first round of consultations with media and government institutions, and it is currently with the Attorney General. CSO regulations are under consultations as well. They have been replaced in the DPF2 matrix by another transparency-enhancing Proclamation on Federal Administrative Procedures, while related actions will be kept as triggers for DPF3.</th>
<th>Completed</th>
<th>None</th>
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<thead>
<tr>
<th>Indicative Trigger #9.1: (i) The Council of Ministers submits to Parliament an SOE Proclamation reflecting international good practice on state ownership, level playing field, governance structures and policies, financing, debt management, performance management, transparency, and disclosure requirements.</th>
<th>Prior Action #10: (i) The Council of Ministers has issued Regulation No. 445/2019 authorizing the creation of a holding entity for SOEs. (ii) The Council of Ministers has approved for submission to Parliament a draft Privatization of Public Enterprises Proclamation, which sets out a framework for the privatization of public enterprises.</th>
<th>New action. The originally proposed Proclamation on SOEs is currently under consultation, to help mitigate risks resulting from potential pushback by stakeholders. The Proclamation is kept as a trigger for DPF3 and has been swapped with the creation of a holding entity for SOEs, originally proposed as a trigger for DPF3 and already established, as counterparts accelerated implementation. In addition, the prior action has been strengthened with the inclusion of a new Privatization Proclamation that focuses on divestiture decisions, while the SOE Proclamation focuses on the governance of SOEs.</th>
<th>(i) Completed</th>
<th>(ii) Completed</th>
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</table>

TA on SOE reform with MoF
Pillar 1: Maximizing finance for development

32. Maximizing finance for development will entail identifying sustainable ways to finance infrastructure and improving efficiency in key growth-enabling sectors. The Government’s current model for financing infrastructure investment cannot be sustained indefinitely. In Ethiopia’s financial sector, the Government rations domestic credit between competing uses, directing the bulk of domestic bank credit to publicly provided infrastructure and basic services. While this has allowed Ethiopia to greatly increase its public capital stock, it has also led to the rapid accumulation of both external and domestic public debt, as well as the crowding out of the private sector. Although the new assets are expected to generate growth and additional revenue in the medium term, Ethiopia faces significant liquidity constraints in the short run. Going forward, it will need to identify sustainable ways of financing infrastructure and improve efficiency in key growth-enabling sectors such as energy, telecom, and logistics. This can be achieved by: (i) promoting PPPs; (ii) improving efficiency and restoring financial sustainability in the power sector; (iii) introducing competition in the logistics sector to reduce costs and improve efficiency; and (iv) introducing competition and foreign participation in the telecom sector to improve connectivity.

Objective 1.1. Promoting public-private partnerships

33. Rationale: Given Ethiopia’s large investment needs, PPPs can constitute an important channel for mobilizing private financing while improving sectoral efficiency. In recent years, the Government has implemented PPPs with four PPP projects reaching financial closure for a total investment commitment of over US$124 million. While the country has thus acquired some experience in the PPP market, it has lacked a solid regulatory framework and suitable institutions to attract private sector operators and leverage private financing while being fiscally responsible. According to the Procuring Infrastructure PPPs 2018 report, Ethiopia scores 15 percent out of 100 in PPP preparation procedures and 41 percent in contract management, well below the levels observed in neighboring countries such as Kenya or Uganda. The recently created PPP Board has listed 17 PPP projects to start implementation in FY20 and FY21, including eight solar generation projects, five hydropower projects, one electricity transmission project, and three highways, potentially amounting to US$7 billion in investments. Selection and implementation of this ambitious pipeline requires a fully fleshed out PPP regulatory framework as well as substantial capacity building.

34. Two related areas require special attention. First, fiscal risks stemming from contingent liabilities in PPP contracts, an area in which capacity is currently lacking, must be managed. Second, the Environmental and Social Impact Assessment (ESIA) system must be strengthened. The 2002 EIA Proclamation gives the Environmental Protection Authority (EPA) the authority to review, approve, and enforce ESIs, but EPA delegated that authority to six-line ministries in 2007. Analyses and stakeholder consultations have shown that this delegation of authority has led to major shortcomings, including projects with significant environmental and social impacts being approved without rigorous or
independent government review. These issues are attributed primarily to a lack of capacity in the line ministries and to conflicts of interest between the environmental and social screening function of the delegated ministries and their ordinary regulatory function.

35. Solutions: In 2018, the Parliament approved the first building block of the regulatory framework: the PPP Proclamation. To ensure adequate implementation of the Proclamation, the World Bank has been supporting the recently established PPP Directorate at the MoF in the elaboration of Implementation Guidelines detailing the required procedures and authorizations to undertake PPP transactions (DPF2 Prior Action #1). These guidelines are critical to ensure all PPP projects undergo the same screening and processing steps, including by complying with criteria that are part of the broader Public Investment Management framework. Specific guidelines for key sectors are included as well. To manage potential fiscal risks stemming from contracts, the PPP Guidelines also foresee the need to assess contingent liabilities related to the sovereign contractual obligations prior to project approval. Toward that end, the World Bank has initiated its collaboration with the MoF to build the capacity needed to evaluate contingent liabilities. In order to overcome capacity constraints in terms of screening, negotiating and monitoring PPP projects, the World Bank has started a dedicated technical assistance as well to provide capacity building on the implementation of the legal framework approved under DPF1 and DPF2, and several donors are providing additional advisory support to the evaluation of PPP proposals.

36. Finally, while the PPP legal framework addresses the need for sound ESIAs, restoring an independent authority for review, approval, and enforcement of ESIAs (DPF3 Indicative Trigger #1.2) is crucial for the Government to account for environmental externalities and implement risk mitigation measures during the life of the project. To mitigate potential risks arising from PPP projects approved before the updated ESIA framework is adopted, the World Bank team providing support in this area has revised the PPP Guidelines to include the pertinent provisions on ESIAs. The World Bank is helping to create an enabling environment for PPPs, and notably, it is not supporting any hydropower or transportation projects in the pipeline.

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**DPF1 Prior Action #1**: Parliament has approved the PPP Proclamation, and MoF has issued the PPP Directive to establish a regulatory framework and institutions that manage fiscal risks and enhance transparency, fairness, and long-term sustainability in implementing privately financed projects.

**DPF2 Prior Action #1**: The PPP Directorate General has issued PPP Implementation Guidelines with the required procedures and authorizations to undertake PPP transactions, including an assessment of the contingent liabilities related to the sovereign contractual obligations.

**DPF3 Indicative Trigger #1.2**: (i) The Council of Ministers adopts and submits to Parliament an amendment to Proclamation No. No. 299/2002 on Environmental Impact Assessments that strengthens the federal ESIA system, including by restoring independent authority to review, approve, and enforce ESIA. (ii) The Environment, Forests, and Climate Change Commission promulgates a directive on public consultations in ESIA.

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23 Energy, transport, industrial parks, health, housing and water sectors.
37. **Expected results:** All PPP transactions are implemented according to the guidelines. The fiscal treatment of PPP projects and the independent enforcement of the ESIs are essential pieces that complement the PPP proclamation and PPP guidelines. They provide the overall solid governance that the Government needs to develop the PPP market. These reforms will ultimately help build confidence in the fairness and transparency of the process, leading to greater predictability of pipeline project quality and instilling confidence in the public and investors, thereby minimizing risks, increasing investments in infrastructure PPPs, and ensuring long-term fiscal, environmental, and social sustainability. Implementation of clear environmental and social guidelines for PPPs, combined with higher anticipated levels of investment in sectors supported through PPPs, would likely have positive poverty and social impacts through job creation and better working conditions for employees.

38. **Climate change mitigation co-benefits:** The promotion of PPP projects, which will be achieved through the implementation of Prior Action #1, is a central building block for Ethiopia’s electricity sector. Most of the projects currently being implemented under the newly approved PPP framework and guidelines will utilize non-hydro renewable resources such as solar, wind, and geothermal. These projects will help reduce the vulnerability to droughts, thus improving climate adaptation, and mitigate emissions from back-up power since in the past, droughts have often led the power utilities to fall back to diesel-powered emergency generation.

**Objective 1.2. Improving efficiency and restoring financial sustainability in the power sector**

39. **Rationale:** The transition to a competitive and industrial economy will need affordable and reliable energy. Over US$10 billion has been invested in power generation, transmission, and distribution over the past decade to meet increasing demand, which has been growing at over 15 percent per year. However, poor service delivery, operational performance, and financial management pose substantial challenges for the state-owned utility companies, Ethiopian Electric Utility (EEU) and Ethiopian Electric Power (EEP). Ethiopia’s electrification rate stands at only 43 percent, and the country has the third-largest population of people without electricity access in SSA. Tariffs remained constant in nominal terms for over a decade, declining in US$ terms to 0.02 US$/kWh in 2018, the second-lowest tariffs on the continent. The utilities largely rely on short-term bonds to finance long-term power assets, which has created a cash flow problem and debt overhang. The power sector’s total liabilities stood at 15 percent of GDP in 2018. Since the Government guarantees the utilities’ debt, it is providing implicit subsidies and facing fiscal risks of non-payment. While the direct internationally held debt service obligations of the utilities are generally met on time, most of the domestically held debt is routinely rolled forward, creating

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24 In collaboration with the Public-Private Infrastructure Advisory Facility, the PPP Directorate General has developed screening criteria for identifying pipeline projects that are consistent with the PPP Proclamation and the PPP Guidelines (including inclusion of project in national and sector plans, social and environmental constraints, and indication of financial viability as a PPP). These criteria have been used to screen the current list of projects in the PPP Pipeline, which will be updated on a regular basis.

25 the last major drought in 2008-10 saw diesel power rising to 10 of generation and increased the grid emission factor from 2 gCO2/kWh in 2007 to 95 gCO2/kWh in 2009.

26 Operational performance, with system losses at 23 percent and collection rates at 85-90 percent, lags international benchmarks and demonstrates significant scope for revenue enhancement.

27 In 2013, Ethiopia separated the monolith Ethiopian Electric Power Company (EEPCo) into Ethiopian Electric Utility (EEU) and Ethiopian Electric Power (EEP).
significant risks, especially for the CBE, whose credit exposure is highly concentrated in the energy sector. In practice, as the sole stakeholder, the Government absorbs the utilities’ net losses and has recapitalized the SOEs three times in the past decade. Transmission and distribution losses amount to about 20 percent, of which 5 percent are commercial losses.

40. **Solutions:** Ethiopia’s National Electrification Program (NEP), launched in November 2017, aims to provide efficient and reliable electricity services to all by 2025. To achieve this objective in a financially and fiscally sustainable way, the government has initiated an integral set of reforms that include (i) a four-year schedule of tariff increases to boost sector revenues and restore debt servicing capacity (Box 2; DPF2 Prior Action #2); (ii) the restructuring of debt held by troubled energy utilities, with the MoF converting into equity over US$1 billion in loans that had been on-lent to EEP (DPF2 Prior Action #3); (iii) use of PPPs (DPF2 Prior Action #1) to limit the need for public financing for generation, transmission, and distribution investments going forward; (iv) measures to improve the operational efficiency, service delivery, and customer service of the power utilities, included in the sector roadmap under preparation; (v) institutional reforms to enhance accountability and transparency in the sector and create a level playing field for private investment. The power sector reform agenda envisaged by this DPF builds on and is supported by a robust ongoing technical assistance program as well as nearly US$2 billion in IDA investment operations using a variety of World Bank instruments—guarantees, program for results, and investment project financing. These ongoing World Bank engagements are expected to deliver electricity access to 1.2 million households through grid and another 1.5 million households through off-grid solutions, as well as support the expansion of renewable energy-based electricity generation through the public private partnership model.

**DPF1 Prior Action #2:** The Recipient’s Council of Ministers has approved a multi-year electricity tariff increase framework with a detailed implementation schedule to improve cost recovery while protecting the poor.

**DPF2 Prior Action #2:** Under supervision of the EEA, the EEU and MoWIE have announced the implementation of a second electricity tariff increase under the multi-year electricity tariff increase framework in December 2019.

**DPF2 Prior Action #3:** The Government’s Macroeconomic Committee has approved a phased restructuring of EEP’s debt in the power sector and the Ministry of Finance has implemented a conversion of loans on-lent to EEP into equity.

**DPF3 Indicative Trigger #2.2:** (i) Under supervision of the EEA, the EEU and MoWIE announce the implementation of a third increase under the tariff framework in December 2020. (ii) Under the approved restructuring of EEP’s debt, the MOF completes the takeover of EEP bonds held by CBE. (iii) Pursuant to the institutional reform roadmap, the power sector agencies implement the first year’s actions.

41. **Expected results:** The reforms will help achieve the institutional restructuring of the power sector, improve efficiency on the demand side by increasing average effective electricity tariffs, improve efficiency on the supply side by reducing commercial and technical inefficiencies, and improve financial performance by achieving cost recovery and increasing the power sector debt service coverage ratio. The
tariff reform in December 2018 under DPF1 restored operating cash flow recovery for the two power utilities (see Box 2 for details).

42. **Climate change mitigation co-benefits:** Consistent with the World Bank’s 2016 Climate Change Action Plan and Ethiopia’s Nationally Determined Contributions (NDCs) to the Paris Agreement, these prior actions, which relate to efficient pricing of electricity and reduction of system losses, are energy efficiency measures. Tariff reform, combined with demand-side efficiency gains and system-wide loss reduction through the implementation of the performance improvement plan, are important efficiency measures consistent with Ethiopia’s NDC. As the roll-out of the first stage of tariff reform has already shown, demand declined by 14 percent after per-unit prices increased by 86 percent. The restructuring of the utility debt and the reform of the electricity tariff will lend additional financial freedom to the country’s power sector. Restructuring of the power sector debt will free up financial resources that can then be utilized toward achieving Ethiopia’s target of universal electrification by 2025. With a fully renewable and more reliable power supply, there will be a reduced need to reduce the need for consumers to rely on fossil-fueled back-up power, biomass and charcoal for cooking and heating are expected to be replaced with electricity, overall reducing household CO2 emissions.

**Box 2: Electricity Tariff Reform Implementation**

In September 2018, Ethiopia’s Council of Ministers approved a four-year electricity tariff reform, and Ethiopia Electric Utility (EEU) implemented the first adjustment as planned in December 2018. The volume-weighted average price per kWh is estimated to have increased by 86 percent in January-April 2019 compared to 2018. Subsequent annual increments will further raise tariffs by 65 percent, 22 percent, and 19 percent on average during 2020-22.

The tariff reform’s impacts are concentrated in the top quintiles, for two main reasons. First, only about 32 percent of households have access to electricity in their home, most of whom are in the upper quintiles of the income distribution. Second, the lowest tariff brackets were fully or mostly exempt from the increases, as the government decided to have higher residential consumer classes subsidize lower-income residential groups. See Section 5.1 for more details on the Poverty and Social Impact Analysis.

Roll-out of the tariff reform in December 2018 was accompanied by an awareness campaign by EEU and MoWIE to inform the public and various stakeholder groups about the changes (including advertisements in the media and awareness events for stakeholders).

The new tariffs raised revenues and appear to have induced efficiency effects, but implementation of the performance improvement plan will be critical to maintain acceptance of higher prices by consumers. EEU’s total monthly sales increased by 61 percent during January-April 2019 compared to the pre-reform year, despite a price-induced reduction of demand by 14 percent. This improved EEU’s and EEP’s cost recovery and the related contingent liabilities to the fiscal budget. Net losses in the sector peaked at around US$750 million in FY18 or 1 percent of GDP. They went down to 0.6 percent of GDP already in FY19, thanks in large part to the tariff reform. Net loses are estimated to fall below 0.2 percent of GDP by the end of this DPF series.

However, a feedback survey reported that most customers think that the tariff increase is “not appropriate”, as the quality of the electricity services needs further improvement. EEU received similar feedback from its larger customers over the last few months, who were concerned about service quality rather than the tariff adjustment. Going forward, MOWIE, EEU and EEP would implement a Performance Improvement Plan, which would help improve customer service, enhance maintenance practices, and reduce outages. In

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28 Poverty and distributional impacts of energy tariff reform are described in more detail in Section 5.1 and Annex 4.
In addition, quality of service is expected to improve with increased electricity generation and efforts to address vulnerability to lower hydropower generation during drought years.

Objective 1.3: Introducing competition in the logistics sector to reduce costs and improve efficiency

43. Rationale: High logistics costs in Ethiopia undermine the competitiveness of export-driven light manufacturing and agriculture, compromising the main areas of focus under the GTP II. Inefficiencies in trade logistics pose a major challenge to Ethiopia’s external competitiveness. The cost of shipping a 20-foot container to Germany from Ethiopia is 247 percent higher than from Vietnam and 72 percent higher than from Bangladesh. Ethiopia was ranked 154th out of 189 economies on the “Trading Across Borders” indicator in the World Bank Doing Business 2019 report and 126th out of 160 in the World Bank 2016 Logistics Performance Index, behind other potential competitors in garment manufacturing such as Lesotho, Kenya, Tanzania, and Uganda.29 In addition to the disadvantage of being landlocked, Ethiopia’s poor performance can be explained by several constraints arising from the existing regulatory and institutional setup. In particular, the Ethiopian Shipping and Logistics Services Enterprise (ESLSE) is the sole provider of shipping services, multimodal services, and transfer of goods between Djibouti and Ethiopia, as well as the only operator of dry ports.30 This de facto monopoly impedes provision of efficient logistics services consistent with international standards. In addition, investment in the provision of services in the road transport sector, packaging, warehousing, and freight-forwarding is still exclusively reserved for Ethiopian nationals and obtaining operating licenses for newcomers remains a challenge.

44. Solutions: In 2018, authorities approved and started to implement a National Logistics Strategy defining the policy direction for greater competition and foreign participation in the logistics sector, with the aim of reducing costs and improving efficiency. That same year, to immediately unlock the logistics sector, the Ethiopia Investment Board lifted restrictions on foreign participation in essential logistics services, which has led to the materialization of joint ventures that are expected to help reduce transportation costs (DPF1, Prior Action #3).31 A crucial step toward broadening competition in the logistics sector and reducing costs is to bring an end to the state monopoly of the dry ports.32 The

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29 All these countries qualify under the African Growth and Opportunity Act Third Country Fabric Rule which grants them preferential access to the U.S. market.
30 The corridor connecting Ethiopia and Djibouti is the main trade route for Ethiopia, carrying more than 95 percent of international trade traffic by volume. The core infrastructure that forms the corridor is the port of Djibouti, the dry port at Modjo, the border crossing point at Galafi and highway and railway links that connect the three. The main constraints that are faced in the port are delays with the removal of Ethiopian imports from the port and their transfer to Modjo dry port and other destinations in Ethiopia. The delays largely are a function of the clearance processes in Ethiopia and the availability of transport services, especially road trucks. Road transport is the dominant mode of transport on the corridor, carrying more than 90 percent of Ethiopia’s trade traffic. While there is a recently built railway line, it suffers from three main constraints that hamper its full utilization: (a) freight allocation policy by ESLSE which favors road transport; (b) limited capacity, especially in terms of wagons; and (c) operational inefficiencies in Modjo which delay the offloading and loading of containers. The excessive dwell time of cargo in Modjo reduces the capacity to handle incoming cargo and degrades the operational efficiency of the facility.
31 The joint venture (JV) between Ethiopian Airlines and DHL for a total of US$11 million was the first to materialize—one of the largest of its kind in Africa, it is geared toward providing global solutions for multimodal transport from factory to market based on the needs of manufacturers. Another prospective JV is between ESLSE and the multinational shipping line CMA CGM, covering bonded warehousing and related logistics services.
32 These include storage and warehousing, cold storage, packaging, consolidation and deconsolidation of volumes, import and export clearance, etc.
Government Macroeconomic Committee has decided to allow private sector firms to access and provide services at existing dry ports as well as to own and operate new dry ports (DPF2 Prior Action #4). This needs to be followed by a change in the regulation on the establishment of ESLSE, legal owner of existing dry ports. ESLSE will be subject to the provisions of the proposed Public Enterprise Proclamation (DPF3 Indicative Trigger #9.2) and is expected to continue operating but in a more competitive environment and leveled playing field. In addition, the sector regulator will need to be strengthened to facilitate the entry of new players and ensure fair competition. Building on the introduction of a new customs management system in 2018, the Government will also address some of the regulatory and administrative hurdles in the trade logistics supply chain that undermine efficiency and competitiveness. It will finalize efforts to streamline, simplify, and automate the documentation and approval process by introducing an electronic single-window system to cover all regulatory procedures related to trade clearance (DPF3 Indicative Trigger #3.2).

45. **Expected results:** Reform of the logistics sector will help reduce time and associated costs to import and export and will attract private (including foreign) investment in the logistics sector. Opening of the logistics sector is expected to attract FDI and help develop a new logistics services industry. Improved performance of the logistics sector will ultimately contribute to an increase in exports. Greater investment in the sector is also expected to help reduce poverty in the medium term through generation of new job opportunities. Opening up of the logistics service sector is not expected to have significant environmental effects.

**Objective 1.4: Introducing competition and foreign participation in the telecom sector to improve connectivity**

46. **Rationale:** Ethiopia is one of the last countries in the world to retain a national monopoly on all telecom services (including fixed, mobile, internet, data, and radio communications). For many years, Ethio Telecom’s monopolistic control has limited the scope for innovation, restricted network expansion, and limited the scope of services on offer. Despite recent improvements, mobile cellular subscriptions, at 38 per 100 people, are well below the averages for SSA (72) and other low-income economies (57). While

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33 On logistics the Ethiopia Maritime Affairs Authority is the de facto regulator for logistics and is responsible for issuing operating licences to new entrants into the market. This agency is currently working to strengthening the regulatory regime, to cover the new activities that are now open to competition, in particular in the dry ports.
the share of population accessing the internet is similar to other low-income economies, fixed-broadband subscriptions are exceptionally low at 0.05 per 100 people, and 4G mobile broadband coverage is only 4 percent of the population (GSMA, 2019). According to ITU (2018), the cost of 500 MB of data per month was equivalent to six percent of monthly GNI per capita in 2017, with Ethiopia ranking 149th out of 181 countries in terms of cost of services. In addition, Ethiopia has the lowest use of mobile money among all African countries at just 0.32 percent of adults, with the lowest level of female participation at just 10 percent of the total.35

47. Solutions: Ethiopia has now embarked on a bold strategy to liberalize the telecom sector, promote privatization, and introduce competition. A new Communications Service Regulation Proclamation adopted by the House of People’s Representatives has established an independent regulator for the communication sector, the Ethiopian Communications Authority (ECA).36 In compliance with the Proclamation, an independent Board has been appointed by the Prime Minister (DPF2, Prior Action #5 i). The ECA has convened a public consultation on the requirements for new telecom operator licenses (DPF2, Prior Action #5 ii). This action is significant because the Public Notice includes details about the new market structure (two new entrants), license conditions, and spectrum allocation. It also proposes how the process (auction) for the issuance of new licenses will be conducted and seeks comments from potential investors. Thus, the Public Notice is a clear sign of the Government’s commitment to liberalize the telecom sector. The actual selection and award of two new full-service telecom licenses is expected to take place in 2020, and it is listed as an indicative trigger under the last DPF of this series.

DPF1 Second Tranche Release Condition #1: Council of Ministers has approved the establishment and constitution of an independent regulator for the telecom sector.

DPF2 Prior Action #5: (i) The Prime Minister has appointed the Board for the ECA. (ii) The ECA has convened a public consultation on the selection process for new telecom operator licenses.

DPF3 Indicative Trigger #4.2: Competitive selection of new telecom operators is completed, and licenses are awarded by the Ethiopian Communications Authority.

48. Expected results: The issuance of two new full-service telecom licenses will effectively bring the existing state monopoly in the sector to an end. More specialized licenses are expected to be issued later (e.g., for cell towers, internet service providers, wholesale fiber operators). The introduction of competition in the sector is expected to bring benefits to Ethiopian consumers such as improved quality of access, lower costs, the offering of new digital products and services, and expansion of mobile money. Customers are already benefiting from cheaper prices since the new market structure was announced.

34 World Bank FINDEX 2017.
35 The poverty and distributional impacts of telecommunications reforms are described in more detail in section 5.1.
36 The Ethiopian Communications Authority (ECA) is the independent sector regulator covering the telecommunications and postal services sector. It was created when the Communications Services Proclamation (1948/2019) was published on 2 September 2019.
Pillar 2: Improving the investment climate and developing the financial sector

49. To improve competitiveness, boost exports, and create job opportunities for the growing population, the role of the private sector in the Ethiopian economy needs to be strengthened by addressing challenges that affect the investment climate, financial sector, and capital markets. The Government needs to ensure that the conditions are in place for a more vibrant private sector. This requires coordinated efforts to improve the business climate by issuing regulations that reduce administrative burdens and restrictions on both domestic and foreign investors, removing constraints within the financial system to expand credit to the private sector, and initiating the establishment of the government securities market.

Objective 2.1: Streamlining business regulations to foster private sector development

50. Rationale: Ethiopia’s regulatory environment for business start-up and operation is restrictive, complex, and unpredictable. Doing Business 2019 ranks Ethiopia 159th out of 190 countries globally and 29th in Africa. Enterprise creation is constrained by burdensome costs for licensing and registration. Licensing regulations also create undue compliance burdens for operating businesses, affecting both domestic and foreign-owned businesses in Ethiopia. The current Investment Proclamation contains barriers to investment entry, with restrictions and prohibitions on FDI in most services sectors. It adopts a positive listing approach whereby FDI can only engage in sectors explicitly listed in the law, with the effect of excluding FDI participation in all other sectors of the economy. As a result, the investment regime is both restrictive and rigid, since it is not open to new sectors and evolving market trends. Most countries have long moved away from the positive list approach.

51. Solutions: To help lift restrictions on private sector participation in economic activities, the Council of Ministers has approved for submission to Parliament a new Investment Proclamation that shifts from a positive list to negative list approach. Sectors not in the negative list will become open to private sector participation, including foreign investors (DPF2 Prior Action #6). The Investment Proclamation is expected to allow foreign sector participation via joint venture in civil aviation and energy transmission. Sectors such as mass transportation, cement production, professional services, and education and health would become fully open to foreign investors for the first time. Technical teams have been working on the ground to ensure that legislation follows international best practices to foster investment.37

37 The new Investment Proclamation includes better investment protection (relatively broader definition of investment, investment protection and guarantees, dispute resolution provision included for the first time); more efficient investment service provision (e.g., strengthening OSS, multiple entry and longer visa regime); the introduction of a systematic investor grievance handling mechanism; and the establishment of a federal-regional coordination platform on investment matters (Standing Council on Inter-Governmental Relations) to address issues of arbitrary and adverse regulatory/administrative measures as well as weak federal-regional synchronization.
competitive pricing, and market competition. A new Competition Proclamation is expected to be approved in the coming weeks. To modernize the overall legal framework for business in Ethiopia, the Council of Ministers will submit a new Commercial Code to inter alia protect minority shareholders and provide insolvency rules that allow rehabilitation of the debtor’s business (DPF3 Indicative Trigger #5.2). In December 2018, authorities also launched a National Initiative to improve Ethiopia’s Doing Business performance, as part of Ethiopia’s Action Plan for jobs and competitiveness.

| DPF1 Prior Action #4: | The Ministry of Trade has reduced the number of licensing categories by half and eliminated the requirement for annual competence certificates for at least 70 percent of trade-licensing categories to reduce the regulatory burden and simplify business entry, affecting over one million businesses. |
| DPF2 Prior Action #6: | The Council of Ministers has approved for submission to Parliament a draft Investment Proclamation enabling foreign participation in a broader set of economic sectors (shift from positive to negative list of sectors). |
| DPF3 Indicative Trigger #5.2: | (i) The Council of Ministers adopts and submits to Parliament a new commercial code modernizing the legal framework for the private sector in the areas of minority investor protection, insolvency, and reorganization. (ii) The Council of Ministers adopts and submits to Parliament a new proclamation on Alternative Dispute Settlement. (iii) The Council of Ministers adopts and submits a comprehensive proclamation on e-commerce and the e-payments regime in Ethiopia. |

52. **Expected Results**: Investment climate reforms are expected to reduce the regulatory burden on domestic and foreign-owned businesses operating in Ethiopia and, together with reforms linked to the investment and competition proclamations, to contribute to an increase in overall investment, including FDI. Streamlining of business regulations is also expected to help reduce poverty through job opportunities for employees and through self-employment.

53. **Climate change mitigation co-benefits**: The railway transport and large-scale cold-chain transport sectors, currently reserved for domestic non-diaspora Ethiopian investors, will be fully opened to foreign investors under the new Investment Proclamation and its associated regulation. Air transport, freight transport, and mass transport by bus will become open to foreign participation in the form of joint ventures. While the opening of international and domestic air transport could result in the establishment of new commercial routes and higher emissions, this is expected to be offset by a shift of cargo transport to railway transport, which is more environmentally friendly than road transport per unit of cargo carried. Increased competition in mass transport and freight transport by road is expected to result in the introduction of newer, larger, more efficient, and environmentally friendly vehicles. An analysis of the current private sector fleet shows that 32 percent of the trucks are between 10-20 years old, and another 40 percent are more than 20 years old. Old trucking fleets contribute to reduced reliability, high operating costs, and increased CO2 emissions, weaknesses exacerbated by the fact that most of the old trucks have a carrying capacity of less than 20 tons.

**Objective 2.2: Removing constraints to access to credit in the private sector**
54. **Rationale:** With total assets of 52 percent of GDP, Ethiopia’s financial system is shallow and does not sufficiently support economic transformation. Access to finance has been identified as the main obstacle to doing business by 40 percent of firms, and credit to the private sector stood at just 13 percent of GDP in 2018. Most businesses and households lack access to long-term finance, and the banking system provides a limited range of traditional financial products and services, with mobile money or other fintech innovations being virtually absent in the market. While the share of adults having a bank account has increased significantly in recent years, it remains low, at only 35 percent in 2017 compared to an average of 43 percent in SSA.

55. Notably, the banking sector has a concentrated ownership profile, with state-owned CBE representing nearly 60 percent of total banking assets as of end 2018. CBE raises public and private sector deposits to finance long-term infrastructure projects by purchasing government-guaranteed SOE bonds (especially EEP) and extending loans to the same sector. The resulting asset liability mismatch and high portfolio concentration in specific sectors and enterprises pose systemic risks and crowd out financing to private sector firms. Furthermore, the interest on EEP bonds that have been purchased by CBE has been only partially serviced since 2015, undermining the solvency and liquidity of the bank. Meanwhile, private commercial banks were required to buy five-year NBE Bills equivalent to 27 percent of all loans disbursed (the “27 Percent Rule”). The proceeds have largely gone to fund the Development Bank of Ethiopia (DBE), which provides lending for private sector projects, thereby re-injecting mopped-up excess liquidity back into the financial system, which undermines monetary policy implementation.

56. **Solutions:** In a significant shift away from the current model of public financing, the NBE removed the 27 Percent Rule in November 2019 (DPF2 Prior Action #7). This is expected to free liquidity for private banks to increase private sector credit, with an increase in loanable funds estimated at about ETB 19 billion or 11 percent of outstanding loans in FY20. For an economy growing at near 20 percent nominally, this additional liquidity is expected to be easily absorbed, and the issuance of new treasury bills that provide returns at market-determined rates (DPF2 Prior Action #8) can help financial institutions diversify their portfolio and manage liquidity. Some banks have already announced a reduction in their lending rates as a result of the removal of the 27 percent rule.

57. The repeal of the 27 Percent Rule affects the DBE, as the public bank will need to find alternative sources of financing. DBE funding needs for FY20 are expected to be covered by the 27 percent proceeds collected until the rule was repealed. This will minimize operational disruptions as the institution embarks on a comprehensive reform program aimed at achieving financial sustainability, with a strategic review that includes an asset quality review as well as an alternative funding plan to proceeds from the 27 Percent Rule as a departure point. Similarly, along the lines of a roadmap for financial sector development that is currently under preparation, another committee is evaluating the role of the CBE, a critical stumbling block toward financial sector modernization. As a first step, CBE has completed the International Financial Reporting Standards (IFRS) compliance audit by an international audit firm.

*DPF2 Prior Action #7: The Board of the NBE has repealed the 27 Percent Rule.*

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58. **Expected results:** The phasing out of the 27 Percent Rule is expected to shift credit supply toward the private sector and free liquidity for private sector participation in auctions of securities (see DPF2 Prior Action #8 below).

**Objective 2.3: Establishing the government securities market**

59. **Rationale:** A major element of Ethiopia’s state-driven development strategy has been to allocate financial resources to the public sector and priority economic sectors, using administrative measures and repressing interest rates. While the current model of extremely restrictive financial regulation may have been appropriate in the early stages of Ethiopia’s economic acceleration, its efficiency and sustainability are questionable given the persistently high inflation, negative interest rates on loans to the public sector, and concentration of risks in state-owned financial institutions. To better serve the financial needs of the economy and limit the Government’s financial exposure to SOEs and state-owned financial institutions, financial regulation must evolve toward a more market-oriented approach that promotes the efficient allocation of scarce financial resources. The lack of a market for government bonds impairs the deepening of the financial system, and the absence of a benchmark (risk-free) yield curve has disincentivized the development of long-term finance instruments and markets by the private sector.

60. **Solutions:** In November 2019, authorities have approved the issuance of new treasury bills under market-determined interest rates. In addition, authorities have started to conduct public auctions of the new T-bills twice a month (DPF2 Prior Action #8). For FY21, the MoF is expected to make public a calendar of auctions under this new instrument to enable private sector participants and investors to better plan their portfolios (DPF3 Indicative Trigger #7.2). MoF and NBE have received World Bank and IMF technical assistance on the legal and technical requirements to conduct this type of auction and establish the foundation for a securities market.

| DPF2 Prior Action #8: The Board of the NBE has approved financing through instruments at market-determined rates, and the first auction of treasury bills was conducted in December 2019. |
| DPF3 Indicative Trigger #7.2: The Ministry of Finance publishes a calendar of auctions of treasury bills at market-determined rates for FY21. |

61. **Expected Results:** Establishing a domestic market for government securities would help better align the cost of government borrowing with the availability of domestic savings and encourage the Government to improve the value for money of public spending. The NBE will be able to use the secondary market for its monetary and liquidity management operations. The introduction of securities at market-determined interest rates is also expected to help develop a yield curve that would facilitate the introduction of new instruments with longer maturities, which could eventually replace external financing.

39 During the December 4th auction, the bids received (ETB 439 million) were below the amounts offered (ETB 500 million), and the weighted average yields were 7.65 percent and 6.47 percent for the 28 and 91-day bills, respectively. The auction held on December 18th, in turn, registered higher bids received (ETB 660 million) than amounts offered (ETB 500 million), with the weighted average yields setting at 5.24 and 4.63 percent, respectively. The auction taking place on January 1st concluded with weighted annual yields of 8.79 and 6.94 percent, and that of January 15th with 6.15 and 5.61 percent. The existing stock of T-bills at fixed rates was rewarding 0.78 and 1.2 percent (for 28 and 91-days bills, respectively), and is to a large extent held by the pension funds.
and would compensate for the higher interest costs with lower debt amortization costs per year. These measures are expected to contribute to enhanced fiscal and monetary management in Ethiopia.

Pillar 3: Enhancing transparency and accountability

62. **Transparency and accountability in the conduct of public affairs and access to information by citizens, civil society, the private sector, and media create an important feedback loop.** This feedback loop is critical for strengthening service delivery, helping the Government and public enterprises direct resources to where they are needed, enhancing the investment climate for the private sector, and empowering citizens in matters affecting their lives. Going forward, it will be important for Ethiopia to promote citizen engagement and social accountability and to increase transparency and accountability in SOEs and their privatization process.

**Objective 3.1: Promoting citizen engagement and social accountability**

63. **Rationale:** Citizen access to information and wider public participation in the country’s development remain limited. Despite the innovations and progress in public dialogue and participatory planning of services shown recently by the new Government, practical and structural constraints still exist, along with mechanisms of consultation used by the Government that are inadequate for contemporary challenges. Public institutions rarely disclose information—including on their performance—and continue to limit their provision to aggregated information. Despite the launch of the open data portal since 2016, the number of datasets and information uploaded on the portal remain limited mainly because proactive disclosure is not mandatory under the 2011 law. Furthermore, Ethiopia lacks a clear strategy outlining how its regulatory system and institutions will be managed, including principles, objectives, and reform modalities. It is unclear how many existing proclamations, directives, circulars, and standards are being applied, and there is no single repository where information about existing laws and regulations can be accessed. Procedures for consulting on regulatory issues are ad hoc, and the recurring cycles of regulatory failures underscore the importance of strong institutions and effective cross-cutting governance practices to ensure regulatory quality.

64. **Solutions:** The new leadership of Ethiopia has demonstrated its commitment to citizen engagement in public life and is undertaking a series of revisions for several restrictive laws. The Government has already embarked on the implementation of the new CSO Proclamation approved under DPF1, including re-registration of CSOs, and it is preparing complementary CSO regulations and a Civic Engagement Policy. In addition, to improve regulatory quality, the Council of Ministers has approved for submission to Parliament a Federal Administrative Procedure Proclamation that provides for routine publication and consultation on draft Directives, both becoming one of the requirements for their effectiveness (DPF2 Prior Action #9). The World Bank team has reviewed the proclamation and provided feedback to authorities, and it is comfortable with the consultation process that it institutes, although it
will be important to ensure the exemption are not indiscreetly in order to avoid consultations. Finally, the Government is preparing an Access to Information Proclamation, which is expected to be approved in the coming months. To ensure effective implementation, the Council of Ministers will need to approve the necessary implementation regulation and assign the institutional authority to execute the law (DPF3 Prior Action #8.2).

DPF 1 Second Tranche Release Condition #2: The Council of Ministers has approved for submission to Parliament a draft CSO Proclamation to promote greater CSO and citizen participation in the development process.

DPF2 Prior Action #9: The Council of Ministers has approved for submission to Parliament a Federal Administrative Procedure Proclamation that provides for routine consultations on draft Directives, subject to specified exemption(s), and consultation is one of the pre-requisites for adoption of Directives.

DPF3 Indicative Trigger #8.2: (i) The Council of Ministers has approved regulations to implement the new Access to Information Proclamation to provide citizens with greater access to information and data held by government ministries and agencies in Ethiopia.

65. **Expected results:** The proposed actions are expected to result in a qualitative change in citizen engagement, with CSOs fully empowered to engage in social accountability and service delivery activities. The CSO Proclamation is already allowing CSOs working on issues related to democracy, advocacy, and human rights to initiate or formalize operations. The Administrative Procedure Proclamation foresees public consultations and a grievance redress mechanism that will help empower citizens. The Access to Information Proclamation will enforce the disclosure of information to facilitate public debate and citizen engagement. These triggers are complemented by other efforts already initiated by the Government, including the preparation of a new Media Proclamation and a Civic Engagement Policy. Strengthened CSOs and better access to information can contribute to improved citizen engagement and accountability, including greater inclusion of socially and economically disadvantaged groups—which are often represented by CSOs—in the development process. The reform of the CSO and Access to Information Proclamations are expected to have neutral poverty and distributional effects in the short run but positive effects in the medium and long run. In addition, the new Federal Administrative Procedure is expected to improve regulatory quality. These reforms are not expected to have significant environmental effects.

**Objective 3.2: Improving SOE management, transparency, and accountability**

66. **Rationale:** The 40 wholly state-owned public enterprises play a key role in the Ethiopian economy in delivering a wide range of critical public goods and services. While some SOEs perform well, others underperform in relation to their mandates and objectives and provide an inadequate return on investment, resulting in inefficient service delivery, financial losses, and debt accumulation. SOEs’ underperformance stems from weaknesses in their governance and management, which result in a lack of operational autonomy and a lack of transparency and accountability in the use of public assets.

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40 Exemptions to compulsory consultations include: emergency cases, when the issuance of advance notice may be contrary to public interest, and when the issuance of notice may undermine the implementation of the Directive.
Institutional opacity makes it difficult for MoF and line ministries to exercise the proper oversight and due diligence. Some of the largest and most strategic SOEs are scattered among nine ministries, which combine the shareholder function with the policymaking and regulatory function. This governance structure gives rise to potential conflicts of interest, politicized boards and management structures, weaknesses in management performance, and low levels of transparency and disclosure. The lack of transparency (e.g., lack of disclosure of financial statements) also makes it difficult for the Government to assess fiscal risks and/or restructuring needs to attract private sector funding and enable the Government to meet its privatization targets. In addition, the previous legal regime on privatization, dating back to the 1992, was outdated, with no clear provisions for partial privatization or to accommodate the divestiture of strategic SOEs.

67. **Solutions:** The Government is carrying out an ambitious reform program to improve the efficiency and creditworthiness of SOEs along two broad tracks: (i) partially privatizing strategic SOEs to bring in modern management practices and improve efficiency and fully divesting non-strategic SOEs and (ii) improving the broader regulatory environment for SOEs. To ensure a modern and transparent privatization process, the Council of Ministers has approved for submission to Parliament a revised Privatization Proclamation that lays out procedures as well as governance and implementation arrangements (DPF2 Prior Action #10). The revision of the privatization law will enable the Government to execute the ongoing efforts to privatize strategic SOEs through a clear and transparent process that defines the responsibilities and accountabilities of different institutions. Notably, while the Privatization Proclamation provides the legal framework for privatization processes, it does not identify specific SOEs.

68. In January 2019, the Government issued a new regulation to reorganize its institutional arrangement for the oversight of SOEs by establishing the Public Enterprises Holding and Administration Agency (PEHAA). The creation of PEHAA is significant because, for the first time, Ethiopia will have a supervisory agency in charge of the oversight of SOE management, ensuring they introduce and report key performance indicators, adopt IFRS, and comply with the upcoming PE Proclamation. PEHAA is scheduled to publish a first annual report on operational and financial key performance indicators by early 2020. Finally, as an essential element of the new legal framework governing SOEs, authorities have also drafted a new Public Enterprise Proclamation in line with international good practices, including the rationale for state ownership, level playing field, governance structures and policies, financing, debt management, performance management, transparency, accountability, and disclosure requirements (DPF3 Indicative Trigger #9.2). The Proclamation proposes a merit-based governance structure at the

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41 The nine strategic SOEs (sugar, railways, shipping and logistics, construction and water, telecoms, airlines, electric power, electricity utility, and industrial parks) are expected to drive about 40 percent of infrastructure investment required by the GTP II, invest about ETB 900 billion in infrastructure over the plan period, and contribute about ETB 80 billion in fiscal flows.

42 This DPF supports the introduction of appropriate accountability and decision-making structures for the process but does not include actions conducive to privatization for specific sectors. Actions on specific SOEs have yet to be determined by sectoral assessments and publicly announced.


44 PEHAA emerged from a former line Ministry of Public Enterprises and has been brought under the oversight of the MoF, which holds the ownership rights of most SOE’s. It is important to note that PEHAA is only one of the supervising agencies for the SOEs. Other line ministries such as Transport or Agriculture have supervisory authority over SOEs set up to carry out sector specific policy objectives. The governance and management of SOEs, the mandates, the roles and responsibilities of MoF, Supervisory authorities etc are laid out in the draft revised PE law currently under consultations within the Government.
Board and management level, imposes minimum requirements for candidates for these positions, and includes restrictions on appointment of public officials. It also proposes principles for fiscal performance and financial discipline, including compliance with IFRS. SOEs with a minority of private sector stakeholders will be governed by the new Commercial Code (DPF3 Indicative Trigger #5.2).

**DPF1 Prior Action #5:** The Council of Ministers has approved Guidelines for privatizing SOEs that establish the objectives and principles of the privatization process, clear institutional responsibilities for managing private participation in strategic SOEs, and transparency and accountability provisions.

**DPF1 Second Tranche Release Condition #3:** MoF has expanded the scope of its existing debt reporting arrangements to (i) provide detailed coverage of the domestic debt of SOEs, including by instrument and debt holder on a quarterly basis, and (ii) disclose an annual report on public debt (including SOE debt) consistent with good practice; both by January 2019.

**DPF2 Prior Action #10:** (i) The Council of Ministers has issued Regulation No. 445/2019 authorizing the creation of a holding entity for SOEs. (ii) The Council of Ministers has approved for submission to Parliament a draft Privatization of Public Enterprises Proclamation, which sets out a framework for the privatization of public enterprises.

**DPF3 Indicative Trigger #9.2:** The Council of Ministers adopts and submits to Parliament a Revised Public Enterprise Proclamation reflecting international good practice on state ownership, level playing field, governance structures and policies, financing, debt management, performance management, transparency, and disclosure requirements.

69. **Expected results:** Clear principles set out for decisions related to SOE privatization are expected to support the implementation of actions in Pillar I of this operation and thus contribute to the results outlined in that Pillar. Better-managed SOEs will likely: improve the delivery of critical services for businesses and consumers; reduce the fiscal risks to the Government; protect minority shareholders (including foreign); and more easily attract private sector financing and investment, especially for infrastructure and other critical sectors. A growing number of SOEs will become IFRS compliant and publish on a timely basis (on the respective MoF and PEHAA websites) their annual audited financial statements, as well as their Board of Directors’ performance report. The reform and privatization of SOEs may have a negative impact on jobs when implemented but are anticipated to increase efficiencies in the medium to long term, leading to more access and better quality of products and services with overall positive poverty and social impacts. SOE reforms supported by this operation prioritize the establishment of a clear framework that will also include consideration of the employment implications of envisaged reforms, which will help mitigate poverty and social impacts when privatization and reform decisions are implemented. The disclosure of more information on SOE debt will enhance transparency and accountability and is not expected to have significant poverty or distributional impacts. These reforms are not expected to have significant environmental effects.

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4.3. Link to CPF, Other World Bank Operations, and the WBG Strategy

70. This programmatic DPF series aims to address two overarching challenges Ethiopia faces in improving the lives of the bottom 40 percent and fostering faster and more inclusive structural change, as identified in the WBG’s 2016 Systematic Country Diagnostic (SCD). These challenges are (i) the need
for a sustainable financing model for growth and (ii) inadequate feedback mechanisms for facilitating citizen engagement and government accountability. The DPF series also directly targets specific binding constraints identified in the SCD, including limited credit for private investment and the uncompetitive private sector.

71. The Ethiopia WBG CPF 2018-2022 supports the Ethiopian government’s GTP II and is aligned with the WBG’s twin goals of eliminating extreme poverty and boosting shared prosperity and with the Sustainable Development Goals (SDGs). Given the importance of supporting private sector-led growth, the CPF was prepared jointly with the IFC and Multilateral Investment Guarantee Agency (MIGA). The CPF is organized around three focus areas: (i) promoting structural and economic transformation through increased productivity; (ii) building resilience and inclusiveness; and (iii) supporting institutional accountability and confronting corruption. This DPF will help achieve some specific goals set in the CPF, including: an enhanced business and investment climate; improved access to finance for micro, small, and medium enterprises; adoption of new approaches for sustainable infrastructure financing and debt management; and strengthened citizen engagement and accountability of government entities. This DPF complements actions already supported through WBG operations in Ethiopia on the social and economic inclusion agenda, human capital development, and resilience.

72. The DPF series is also expected to contribute to the objectives set in the IFC country strategy and support the recommendations in the Country Private Sector Diagnostic. This series includes measures to improve efficiency and promote private sector development in key enabling sectors such as energy, logistics, and telecom, as well as measures to streamline business licensing and other regulatory requirements, improve the corporate governance and management of SOEs, and update the privatization legislation.

4.4. CONSULTATIONS AND COLLABORATION WITH DEVELOPMENT PARTNERS

73. Partnerships are a key element of engagement in Ethiopia, and one of the WBG’s strengths has been in leveraging financing and non-lending support from other development partners for large programs such as this DPF series. The World Bank team has joined IMF Article IV preparation meetings and has closely coordinated with the IMF on their recently approved program, which focuses on fiscal reforms, monetary and exchange rate management reforms, and financial sector reforms and that would be complementary to the structural reform package under DPF2. France and Germany have pledged to provided parallel financing amounting to 100 million euros each, and the program in this DPF series has been coordinated with the separate sectoral budget support provided by the European Union. A multi-donor Bank-executed trust fund is being set up to provide comprehensive and coordinated technical assistance to the implementation of DPF-related reforms in this series over the next four years. The Development Assistance Group (DAG), which is the existing architecture for aid coordination in Ethiopia, will be leveraged to that effect. In addition, specific to this DPF series, authorities have put in place a

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45 World Bank Report No. 119576-ET.
46 In support to this DPF series, the World Bank Group has already been working with partners —including the European Union (EU) and its member states, China, Japan, the United States, IMF, and African Development Bank— in providing technical and capacity building in several areas (PPP, domestic revenue mobilization, government bond market, public investment management, investment climate, logistics reform, financial sector reform, SOE reform, and SOE governance).
Technical Committee chaired by the State Minister at the MoF and comprising focal points from the different government agencies as well as development partners (see section 5.4 on Monitoring, Evaluation, and Accountability for further detail).

74. The pillars and objectives of this DPF series are based on a consultative process across different departments of the Government as well as wider stakeholder groups within the country. This DPF series supports implementation of the GTP II, preparation of which was informed by extensive consultations at the federal level and in all regions, involving a broad set of stakeholders including youth, women, farmers, the private sector, CSOs, academia, and development partners. In September 2019, authorities convened key stakeholders to get feedback on the Homegrown Reform Agenda, which contains key reforms supported by this DPF. The Government has also held consultations related to key new regulatory initiatives supported by this second DPF. For example, over the course of its development, the new Investment Proclamation has been discussed with various stakeholders, including public agencies and private sector actors. Regulations and directives on PPP, business regulation, logistics, and financial sector reforms were also informed by extensive Government consultations with private business associations and financial institutions.

5. OTHER DESIGN AND APPRAISAL ISSUES

5.1. POVERTY AND SOCIAL IMPACT

75. Overall, the proposed DPF supports policy and institutional changes that are likely to have poverty-reducing effects, although some negative impacts are expected in the short term. For example, telecom and logistics sector reforms are expected to have direct and indirect poverty-reducing effects, as discussed below. Other structural reforms are also likely to have positive poverty and distributional impacts, although these may take time to fully materialize. Improvements in the business and investment environment through PPPs, a revised investment law, and SOE reform as well as the elimination of the 27 Percent Rule are expected to boost the establishment of new enterprises, lead to a higher level of foreign investment, and expand the volume of credit available to the private sector, while ensuring healthier public finances. This should create additional jobs which can to some extent help absorb the approximately 2 million young Ethiopians who enter the labor force each year. The potential negative effects, particularly concentrated in the short term, mainly consist of job losses in incumbent firms (including SOEs) when these firms are exposed to increased competition or privatization, and a decline in households’ real purchasing power following energy tariff increases. Annex 4 assesses the potential poverty and social impacts of the prior actions in detail and discusses mitigation measures.

76. Liberalization of the telecom sector is expected to have direct poverty-reducing effects as well as transformative indirect effects stemming from increased connectivity. Estimates indicate that more competition in the telecom sector is likely to reduce prices by 25 percent in the short run and by 67 percent in the long run. The direct poverty effects are estimated to be positive but modest—a reduction of 0.2 percentage points in the short run and 0.8 percentage points in the long run. The sharp decline in prices is expected to expand the extensive margin, with more people obtaining access to the mobile network. The indirect impacts of the proposed telco reforms will likely be larger and more transformative: if complementary reforms in other sectors are implemented, mobile devices can help
poor people manage credit better with lower transaction charges and can improve their ability to cope with risks, thereby reducing vulnerability and poverty. Mobile money offers great promise in reducing risks and smoothing consumption through formal and informal insurance and extending financial services to the large share of unbanked people in Ethiopia.

77. **The proposed reforms in the logistics sector are expected to reduce the generalized cost of logistics, with a positive impact on households directly or indirectly involved in import and export activities.** Opening of the dry ports to foreign operators and investors (DPF2 Prior Action #4) is expected to result in a 7 percent reduction in the cost of exports (through improved documentary compliance and handling of goods at the Modjo Dry Port). With railways becoming open to foreign investors (DPF2 Prior Action #6), exports shipped by train will save an additional 8 percent. Computable general equilibrium (CGE) analysis indicates that this would not only help firms but would also lead to gains at the household level. Total employment in the country is expected to increase by 0.8 percent by 2030 as a result of the reforms, with the largest gains in agriculture (the sector that accounts for most of the exports). Household consumption would increase, as well, with the largest gains in rural areas (the origin of most of Ethiopia’s exports). Given that gains of logistics reforms are concentrated in rural areas and among households engaged in agriculture, they will almost certainly have beneficial poverty impacts. World Bank analysis also indicates that opening of dry ports for private sector participation could create over 29,000 direct and indirect jobs (Annex 4).

78. **By allowing for foreign participation in sectors that were formerly exclusively reserved for domestic investors, the new Investment Proclamation is expected to help expand the availability and quality of services.** This includes the socially important sectors of education and health. Opening these sectors to foreign investors is expected to expand the availability and improve the quality of health and education services and bring private education within the reach of a larger segment of the population. The poor, however, may not be able to afford these services. Therefore, it will be important for the government to keep investing in improving the quality of public service delivery and ensure that adequate incentives and regulations are in place to facilitate access to private health and education facilities that meet certain quality standards.

79. **The policy reform of electricity tariffs, while progressive in nature, is expected to have short-term distributional impacts that need to be mitigated.** The original (pre-DPP1) structure of tariff subsidies was regressive, meaning that the benefits were heavily skewed toward the rich. While the direct welfare effects of the proposed tariff adjustment are most negative for better-off households (who consume most of the electricity), the indirect effects are estimated to be largest for the poorest households due to an increase in food prices induced by higher electricity tariffs (Annex 4). The relative welfare impacts are fairly constant across the distribution at about five percent of consumption and are estimated to be higher for female-headed households. Given the low levels of access to electricity in rural areas, the urban poor will be relatively more affected by the tariff increases. Three mitigation measures have been identified. First, the lifeline tariff for electricity remains unaffected by the reform and heavily subsidized, meaning that those who consume up to 50 Kwh will not experience an increase in their electricity bill. Second, the existing Urban Productive Safety Net Project is planned to be scaled up from 11 to 40 cities and from 600,000 to 1 million beneficiaries through the new Urban Safety Nets and Jobs Project. This will provide
relief to many of the urban poor, although further improvements in coverage are needed. The IMF program foresees an increase in the wage paid under the safety nets to compensate for the loss in purchasing power accumulated due to lack of actualization in previous years. Third, the energy team’s project is tackling the issue of shared electricity meters, which will help poor households keeping their electricity bill low. The problem for two thirds of the urban poor is that they often share a meter and therefore cannot benefit from the subsidized lifeline rate. With the support of the World Bank, the Government is currently regularizing the shared connections, and 900,000 meters are expected to be procured in coming months through the Ethiopia Electrification Project. The tariff reform will ultimately allow the electricity provider to become more financially sustainable and to use additional revenue to expand and improve access, mainly to underserved rural areas.

80. While privatization of SOEs may lead to short-term job losses, most employees are well-educated and are expected to benefit from compensation and early retirement packages. Although data is scarce, some evidence suggests that certain SOEs are bloated. For instance, based on a benchmarking exercise against other African telecom operators, Ethio Telecom could be overstaffed by about 40 percent. Generally, most of the SOE employees have characteristics that render them highly competitive on the labor market and could even make them suitable to be employed in other SOEs (see Annex 4). However, a significant minority of SOE employees (around 10 percent) are older and have little or no education. This segment will likely face difficulties in obtaining new wage employment. If lay-offs were to occur, in addition to the compensation and early retirement packages determined by the Privatization Trustee Board, authorities could arrange intermediation sessions through their 1000 existing One Stop Shops on jobs and through private sector led employment services (such as those provided by EthioJobs, etc.) to facilitate the transition.

81. Monitoring and mitigation measures will be adopted to minimize the negative impacts. Indicative Trigger #1.2 under DPF3 will be crucial for social risk mitigation and management, as it will enforce independent review of ESIAs not only in the rollout of PPPs but also for increased private sector investments in areas in which the government remains the regulator for social risk, such as land use planning, labor protection, and gender equality. The licensing process for such investments will need to address and include social inclusion and social protection considerations. In addition, the MDTF that is currently being established to provide technical assistance and advisory services to the Government in parallel with this DPF series will enable monitoring of the reforms’ social, poverty, and distributional effects. The PSIA work under the MDTF will focus on estimating the economy-wide impacts of the reforms, measuring labor market impacts, and formulating appropriate mitigation measures. These measures may include expanding urban safety nets to alleviate adverse effects of the reforms on the urban poor, using active labor market programs to reduce the cost of job search and to up- or re-skill workers in case of

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47 Coverage is expected to reach 33-40 percent of total urban poor at best. In coordination with the WB, the IMF program foresees and support the expansion in the safety nets, including the planned expansion in the government’s contribution to the PSNP from 18 percent to 38 percent. In order to protect the continued adequacy of the cash transfers to existing beneficiaries in real purchasing power terms and enable the financial sustainability of the program over the medium-term, the current PSNP wage rate is expected to increase by 30 percent over the next three years to recover lost real value and would be adjusted by inflation going forward.
layoffs, providing World Bank technical assistance to ensure optimal implementation of the reforms and ensure safeguards, and establishing systems to consult on and monitor the effects of the reforms.

82. **To monitor the impacts of the reforms and to identify whether any groups are being disproportionately negatively affected, a longitudinal high-frequency survey will be established** to follow a representative sample of urban Ethiopian households. A substantial baseline face-to-face survey will be followed by quarterly phone surveys that will focus on changes in welfare, labor market participation, and perceptions of the ongoing reforms. Similarly, a survey among electricity sector clients will be considered to collect information on perceptions of tariff increases and service quality. Finally, the World Bank is supporting the Government in the design of an effective communication plan to maintain public support for the reforms. Several stakeholder consultations are also built into the preparation and approval process for the proposed reforms, which is expected to help ensure citizen support and to identify and address potential issues early.

5.2. **ENVIRONMENTAL ASPECTS**

83. **The reforms supported by this operation are expected to accelerate private sector investment, with potentially significant effects on the environment and natural resources.** These effects are summarized in Annex 6. The policy action most likely to cause negative downstream environmental and social impacts is the promotion of PPPs (DPF2 Prior Action #1). Indirect negative effects could also potentially stem from actions to improve the business climate and foster investment. These actions need to be viewed in the context of Ethiopia’s weak institutional capacity to manage and control the potentially negative effects of investment projects, including the weak system for conducting ESIA and enforcing compliance with the results. Strengthening capacity will be crucial, given that the priority projects identified for PPPs include investments in hydropower, power transmission, and expressways, sectors that frequently present significant environmental and social risks. On the positive side, tariff updating in the energy sector (DPF2 Prior Action #2) is expected to lead to more efficient consumption and improved environmental outcomes.

84. **WBG Country Environmental Analysis (CEA).** The World Bank’s CEA (2017) notes that Ethiopia’s development transformation requires better integration of environmental and sustainability considerations into policy and institutional frameworks to achieve efficient use of resources that contribute sustainably to economic development, poverty reduction, and quality of life. The CEA also outlines policies that would contribute to overall efforts to improve environmental outcomes, including a strengthened ESIA process and the use of economic incentives and provision of information as instruments to encourage environmental improvement. Currently, a key issue is delegation of the authority to review, approve, monitor, and enforce ESIA to the sectoral ministries responsible for investments in agriculture, industry, mines, energy, and infrastructure, which creates a significant conflict of interest.

85. **As a major mitigation measure, the assignment of independent authority to review, approve, and enforce ESIA is included in the third operation in this series (Indicative Trigger #1.2) and will play an important role in ensuring that all public, PPP, and private sector investments are environmentally sustainable.** Additional measures recommended in the CEA include the mandatory disclosure of ESIA, as
well as the extension of this requirement to related monitoring reports to facilitate compliance monitoring and public access to information on environmental and social impacts. Continued efforts to build capacity at the federal, regional, and local levels for environmental and social management and enforcement will also be important. In this regard, the World Bank is providing technical assistance for environmental and social risk management to the Environment, Forest and Climate Change Commission and key line ministries through the MDTF supporting this series.

86. **The DPF promotes policy actions to ensure that future investments in energy are not only fiscally sustainable but also maintain the country’s medium- to long-term low emissions pathway and generate climate co-benefits.** Ethiopia’s NDC under the Paris Agreement on climate change aims to reduce national emissions by 64 percent by 2030 compared to the business-as-usual scenario, but rising energy demand from domestic, commercial, and industrial users and high commercial and technical losses from transmission and distribution threaten this trajectory. The DPF supports policy actions that can help Ethiopia maintain its low emissions pathway and generate climate co-benefits, since Ethiopia has been exclusively meeting its electricity needs with renewable energy. Under DPF2 Prior Action #1, several projects will be considered for competitive procurement, with the majority expected to be independent power producers (IPPs) for renewable energy generation. Under DPF2 Prior Action #2, implementation of the multi-year electricity tariff increase framework promotes efficient pricing of electricity. Prior Actions in this DPF series are aligned with the multilateral development banks’ methodology on climate mitigation finance.

5.3. **PUBLIC FINANCIAL MANAGEMENT; DISBURSEMENT AND AUDITING ASPECTS**

87. **Over the past few years, the Government has demonstrated a credible commitment to modernizing and reforming its PFM and enhancing its efficiency and effectiveness.** Responsibility for ensuring that the PFM system is designed to achieve this purpose has been with the MoF through its expenditure management and control program. Public procurement is regulated by Public Procurement and Property Administration Proclamation, which establishes the Federal Public Property and Administration Agency (FPPA) as the body responsible for regulation and monitoring of public procurement activities. The Government has also instituted several reforms to reduce corruption through the establishment of the Federal Ethics and Anti-Corruption Commission in 2001 and the creation of the Federal Attorney General’s position in 2006. In addition, Ethiopia has developed a legal framework for addressing fraud and corruption risks, although implementation is an issue and corruption remains a roadblock to institutional accountability and governance.

88. **To strengthen the PFM system, the Government has taken a systematic approach to reform focused on “getting the basics of PFM right.”** The reform process began with the reform of the legal framework and the issuance of updated directives and regulations covering all aspects of the PFM cycle. The result has been a steady strengthening of PFM systems over the last ten years. The findings of the Public Expenditure and Financial Accountability assessment for FY2018 indicate that while most indicators remained the same compared to previous years, the Debt Department has improved the recording of income and expenditure information in donor-funded projects, information to sub-national governments on their budget allocations is communicated on time and considered reliable, systems are in place for
contracting loans and issuance of guarantees, and financial statements are compiled and submitted on time. Budget discipline at the aggregate level continues to be reasonably assured. Macroeconomic forecasting and fiscal forecasting are performing well, and payroll management and internal control continue to be reasonable. Audit coverage and quality have improved significantly, although the same unaddressed findings persist year after year. The country has established basic public procurement systems at all levels of the Government (federal, regional, and local levels), and an ongoing reform focuses on improving the efficiency and accountability of the procurement system through modernization, including via the implementation of an Electronic Government Procurement System.

89. **Despite noted improvements, weaknesses remain in the PFM system.** The main weaknesses identified at the federal level are in tax collection, public access to budget information, medium-term perspective in budgeting, and limited parliamentary oversight. Low tax collection by international standards is related to significant constraints in tax administration, both in terms of system shortcomings and poor capacity affecting implementation and compliance. Expenditure budget is presented only for one year, limiting the Government’s ability to plan for the medium term. Fiscal risk monitoring is weak and lacks complete and timely financial information, especially from SOEs, and there are challenges in the management and control of assets and liabilities including shortcomings in undertaking independent economic analysis for major public investments. Public procurement processes are also characterized by several weaknesses which undermine procurement efficiency and effectiveness, including: limited regulatory capacity of FPPA, delays in procurement processes, inadequate application of evaluation criteria, uneven use of standard bidding and contract documents, and weak contract administration capacity and practices.

90. **To further strengthen the PFM system and implement the recommendations from various diagnostics, the Government has developed a PFM reform strategy.** The strategy covers a five-year period from 2018-2022 with the aim “to modernize the PFM system in Ethiopia, promote its transparency, accountability and equity and enhance its efficiency and effectiveness.” The World Bank is supporting the Government in its efforts to reform and strengthen procurement as well as the overall PFM system.

91. **Arrangements for managing forex-related activities at NBE are satisfactory, although the FY18 audit has been delayed.** The latest IMF Safeguards Assessment was completed in 2009. The organizational structure of the NBE is headed by a board, three vice governors (Research, Supervision, and Corporate Services) and multiple directors for the oversight and implementation of the NBE’s role. The Foreign Exchange and Reserve Management directorate is responsible for managing forex-related activities and reports to the Research Vice Governor with relevant directives guiding its operation. World Bank investment credits have been channeled in a satisfactory manner through designated accounts maintained at the NBE. The NBE has an Internal Audit and Risk Management directorate which reports to the NBE’s Board and which conducts risk-based audit and follows up on actions taken. The latest audited financial statements of the NBE are for the fiscal year ended July 7, 2017, as the institution is transitioning to IFRS.

92. **Overall, the fiduciary risk of the proposed operation is considered substantial.** This rating is based on the status of Ethiopia’s PFM system as described above, the current country PFM risk rating per World Bank-financed operations, and the NBE’s internal control assessment. The World Bank portfolio
risk rating is substantial mainly due to weak capacity, staff turnover at the public bodies, weak internal audit function, challenges in procurement and property management, and weakness in resolving repetitive audit report findings on time. A recent World Bank report identified important deficiencies in tax administration and collection, pointing to significant internal control issues that contribute to fiduciary risks. Other factors in the risk rating include limited transparency and weak reporting by SOEs, although shortcomings are expected to be addressed within the new Public Enterprise Proclamation.

93. **Budget disclosure needs further improvements.** The Enacted Budget is published within one month’s time in the Government’s Official Publication repository (the Negaret Gazette) at accessible prices. The FY2019 Federal Budget Summary Volume was also published on the MoF website two weeks after budget approval. An audited annual financial report, incorporating the assessment of an external auditor, is disclosed to the public. However, the executive budget proposal document is not disclosed to the public before it is submitted to the legislature. Ethiopia also lacks a clear, simple summary of the consolidated federal government budget proposal accessible to the non-budget experts, often referred to as a “citizens’ budget.” In addition, in-year and annual budget execution reports are not disclosed to the public.

94. **Disbursement and Accounting.** The Recipient is the Federal Democratic Republic of Ethiopia, represented by the MoF.

- **Disbursement.** The proposed operation will follow IDA’s standard disbursement arrangements for DPFs. After IDA’s Executive Directors approve the proposed financing and the Financing Agreement has become effective, the Recipient will be entitled to withdraw the IDA Grant and IDA Credit in a single tranche. The conditions to disburse include the completed and verified Prior Actions, adequacy of the macroeconomic policy framework, and satisfactory progress in carrying out the Recipient’s program. Financing proceeds will be disbursed by IDA into a dedicated government account for budget support at the NBE, which will form part of the country’s foreign exchange reserves. The authorities will credit an equivalent amount in Ethiopian currency to the government budget. The financing proceeds will not be used to finance expenditures excluded under the Financing Agreement and the World Bank’s DPF policy.

- **Reporting.** The Recipient shall ensure that upon the deposit of the Financing proceeds into the government’s foreign currency account, an equivalent amount is credited in the Recipient’s budget management system. The Recipient will report to the World Bank on the amounts deposited in the foreign currency account and credited in local currency in the Government’s treasury account to the budget management system. Within thirty (30) days of the transfer, the Recipient will promptly notify the World Bank by fax or email that the transfer has taken place and that proceeds have been credited in a manner satisfactory to the World Bank.

- **Excluded expenditure.** If, after being deposited in the dedicated government account, the proceeds are used for excluded expenditures as defined in the Financing Agreement, IDA will require the Recipient to refund directly to IDA an amount equal to the amount of that payment promptly upon notice. Amounts refunded to the World Bank upon such a request will be canceled.
Audit of the deposit account. The Government shall submit an audit of the deposit account by independent auditors acceptable to the Association. The Recipient would: (i) furnish to the Association as soon as available, but in any case not later than three months after the year end, a certified copy of the report of such audit, of such scope and in such detail as the Association shall reasonably request, and make such report publicly available in a timely fashion and in a manner acceptable to the Association; and (ii) furnish to the Association such other information concerning the Dedicated Account and related audit as the Association shall reasonably request.

5.4. MONITORING, EVALUATION AND ACCOUNTABILITY

95. **MoF is the coordinating institution for monitoring and evaluation among all the participating ministries and Federal Government agencies.** Given that the institutional and policy reforms supported by the programmatic DPF series fall under the purview of four ministries (MCIT, MoF, MoT, and MoWIE) and several Federal Government agencies, a Technical Committee was established to oversee the preparation of the operation with clear terms of reference. During preparation of the second operation in this series, this Committee has been expanded to include development partners who are expected to provide parallel budget support, namely representatives from France (Agence Française de Développement, Embassy of France), Germany (Kreditanstalt für Wiederaufbau, Deutsche Gesellschaft für Internationale Zusammenarbeit, Embassy of Germany), United Kingdom (Department for International Development) and the European Union. This Committee will remain in place during program implementation and until completion of the DPF series. MoF is responsible for coordinating the work of this Committee and will engage with the ministries and agencies that are responsible for implementation of the Prior Actions to monitor progress and results.

96. **Data availability and quality are adequate for monitoring progress of the DPF program.** The program outcomes will be monitored through results indicators as detailed in the Policy and Results Matrix (Annex 1). Most of these results indicators are based on routinely published information, and for those that are not, the concerned ministries or agencies will be responsible for collecting the data, tracking the relevant indicators, and providing these to MoF in a timely manner. MoF will be responsible for submitting such information at a frequency and in a format satisfactory to the World Bank. The World Bank will provide support, including technical assistance for some of the reforms described above, to ensure timely implementation and adequate data collection and monitoring of indicators and outcomes of the program.

97. **The DPF program will have grievance redress mechanisms in place.** Communities and individuals who believe that they are adversely affected by specific country policies supported as Prior Actions or Tranche Release Conditions under a World Bank DPF may submit complaints to the responsible country authorities, appropriate local/national grievance redress mechanisms, or the World Bank’s Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address pertinent concerns. Affected communities and individuals may submit their complaint to the World Bank’s independent Inspection Panel which determines whether harm occurred, or could occur, as a result of World Bank non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention and World Bank
management has been given an opportunity to respond. For information on how to submit complaints to the World Bank’s GRS, please visit [http://www.worldbank.org/GRS](http://www.worldbank.org/GRS). For information on how to submit complaints to the World Bank Inspection Panel, please visit [www.inspectionpanel.org](http://www.inspectionpanel.org).

### 6. SUMMARY OF RISKS AND MITIGATION

98. **The overall risk rating of this operation is substantial.** While overall political stability has improved since a new Prime Minister came to office in April 2018, risks remain substantial against a backdrop of tensions and clashes at the subnational level. There are risks of stakeholder backlash against the implementation of an ambitious structural reform agenda that is expected to affect vested interests. Finally, a high risk of debt distress and persistent macroeconomic imbalances point to major macroeconomic challenges that could dampen the expected positive impact of reforms and affect program implementation if left unaddressed.

99. **The overall political environment remains challenging, with several ethnic-based conflicts occurring in different parts of the country.** The widespread civil unrest and violent demonstrations that mainly affected the two large regional states of Oromia and Amhara over the past couple of years have now subsided. The political space is opening, with prominent opposition parties and personalities coming back from exile to take part in the political process. Freedom of expression has also improved, with several private and state media outlets reporting on political issues. However, ethnic-based localized conflicts continue to occur in different parts of the country. In June 2019, two separate attacks in Amhara’s regional capital of Bahir Dar and Addis Ababa killed the region’s president, the national army chief of staff, and several other senior officials in what has been referred to as a coup attempt. In July, dozens of people died in clashes between security forces and activists demanding a referendum to propose Sidama as an independent regional state. Fortunately, the referendum was held peacefully in November. Meanwhile, the Tigrayan People’s Liberation Front is the only party in the former coalition that has not joined the newly founded Prosperity Party. Increased ethnic clashes, tensions between centralized and decentralized forces, or militarization of some opposition groups are risks that would heighten uncertainty ahead of the upcoming general election, planned for August 29, 2020. Increased political instability or postponement of elections could affect completion of the reforms. This operation is key to lock-in ahead of the elections some of the ambitious structural reforms initiated last year, thus mitigating risk of potential reversal. Examples include the second energy tariff increase, the adoption of guidelines for the implementation of the PPP proclamation approved under DPF1, the appointment of the board and the launch of consultations by ECA, or the approval of the privatization proclamation (going one step further than the guidelines approved under DPF1).

100. **While the Government’s reform agenda could potentially increase political tensions, the improvements in governance and participation could help mitigate such effects.** The Government’s ambitious reform agenda is likely to affect the existing social contract and result in winners and losers, which could further exacerbate tensions and result in political instability. However, there is commitment at the highest political level to proceed with the reform agenda, and the government has taken initial steps to improve transparency, accountability, and participation. Accompanying CSO and governance
reforms are expected to foster citizen voice and help mitigate some of the potentially negative impacts by facilitating the feedback loop about challenges in reform implementation. The World Bank carefully monitors the political and governance situation in the country so appropriate mitigation measures can be taken in case these risks materialize.

101. **As discussed in the macroeconomic policy framework section, the major macroeconomic risks are largely related to the external and fiscal sectors.** Overall, the program is highly vulnerable to macroeconomic instability that would undermine the Government’s focus on the structural reform agenda. The authorities’ commitment to continued fiscal and monetary prudence is expected to help reduce macroeconomic imbalances and vulnerabilities. The consensus among experts and stakeholders is that an immediate removal of foreign exchange surrendering requirements and allocation mechanisms without previously reducing imbalances and building up reserves would result in severe macroeconomic instability. It is nonetheless important to note that the results of the DPF program could be affected if complementary measures to reform the foreign exchange market are not implemented. Expected gains in terms of FDI attraction and improved export performance would be hampered as well if there were delays in addressing overvaluation and shortages. There is also risk that increased uncertainty and tensions around the planned national elections hamper the prospects for FDI attraction and delay some of the planned privatizations, or that the exports continue underperforming, which would affect the prospects for foreign exchange receipts. Close monitoring of economic targets under the IMF program and the next DPF in this series is expected to reduce the risk of macroeconomic policy slippage.

102. **The Government’s future reform directions in key sectors are likely to face resistance from stakeholders with vested interests.** While the Government’s intention to allow private participation in power, telecom, transport, and logistics is a positive development, strategies, policies, and governance in these sectors have been weak overall. SOE reforms are politically contentious and can be challenging to implement. Many vested interests within the government (e.g., ministries, other government bodies) and SOEs (boards, management, employees) could potentially attempt to stall reform. External stakeholders such as suppliers, customers, and others might object to greater transparency in SOE commercial dealings. CSOs may also resist reforms involving liberalization and private sector development. Mitigating these risks will require sustained political leadership and commitment, phasing and sequencing of reforms based on political and institutional feasibility, institutional capacity building to manage and sustain the reform process, supporting improvements at the company level, publishing of comprehensive data on SOE performance, and building of support for reform among stakeholders and the public. The Government has sought technical assistance from different stakeholders, including the WBG, to support reform implementation and ensure that sound analysis and consultations contribute to the decision-making process.

103. **Weak institutional and implementation capacity is a major risk.** As Ethiopia strives to gradually move away from a public sector-dominated model toward a more open environment with greater private sector participation, the human, technical, and technological capacity of the ministries and government agencies to carry out the required reforms is an important concern. There is a substantial likelihood that institutional capacity for implementing and sustaining the operation will be weak. Technical assistance
from several development partners, including the WBG, is expected to mitigate this risk to some extent (for example, by supporting the drafting and implementation of Proclamations).

104. **As detailed above, the fiduciary risks are substantial but are being mitigated and closely monitored.** The substantial risk rating is based on the status of the Government’s PFM and procurement systems, the current country procurement and PFM risk rating per WBG-financed operations, and the NBE’s internal control assessment as reflected in the most recent audit report for the year 2017. The deficiencies in the internal control system reported by the audit are being followed up closely by NBE management and do not have a major bearing on the use of this operation’s proceeds. In addition to the ongoing progress in strengthening the PFM system through the Government’s implementation of a PFM Reform Strategy, the WBG is supporting the Government in its efforts to reform and strengthen procurement as well as the overall PFM system through ongoing WBG-financed operations and technical assistance. Progress on these fronts is being monitored closely by the Government and its development partners, including through the PFM Donor Working Group and the WBG’s implementation support in its ongoing operations.

105. **Environmental and social risks are rated as substantial.** The economic transformations proposed by the GoE may lead to disruptions of people’s livelihoods and consequent grievances, particularly in the cases of increased electricity tariffs, potential impacts from the introduction of competition and foreign investment, and employment retrenchments in public enterprises. These issues can be addressed through measures to (i) continuously monitor potential impacts; (ii) establish mechanisms to protect vulnerable people from adverse social impacts; and (iii) engage in strategic communication and consultation with respective stakeholders. Through its engagement in development projects, the World Bank will provide continuing technical assistance and capacity building together with development partners. The sectoral reforms must also be accompanied by improvements in the environmental and social regulatory framework to avoid adverse effects on the environment and natural resources and on the vulnerable population, as well as to promote public participation in decision making on investment projects and their potential social and environmental effects. These issues can be addressed through reinforced and enhanced control over the ESIA decision process by the independent authority to be established under DPF3 Indicative Trigger #1.2.

106. **In terms of climate risks, exposure to climate change impacts is currently moderate, but there is potential for high future exposure.** Ethiopia has experienced more frequent irregularities in climate patterns, including variability in rainfall frequencies and intensity and the persistence of extremes like heavy rainfall causing floods in urban areas such as Addis Ababa and drought in several regions. Future climate variability and change are expected to worsen these conditions, potentially accelerating already high levels of land degradation, desertification, recurrent floods, and water scarcity. Due to Ethiopia’s reliance on hydropower for a significant share of generation capacity, the short- and long-term sustainability of power supply and flooding risks to infrastructure could affect some results of this DPF series, particularly those related to leveraging foreign investment and PPPs. Without appropriate planning, these irregularities may disrupt economic activity and increase fiscal risks. In this DPF, Prior Action #1 is expected to promote private sector investment in new climate smart technologies and

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48 At the time of preparation of this DPF2, SOEs under the oversight of PEHAA have a total of 205,213 employees.
climate-resilient energy systems and in alternative renewable energy sources such as solar and wind that would minimize climate risks. Policy actions that support the implementation of Ethiopia’s ambitious Climate Resilient Green Economy Strategy and GTP II can also help mitigate climate risk.

<table>
<thead>
<tr>
<th>Risk Categories</th>
<th>Rating</th>
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<tbody>
<tr>
<td>1. Political and Governance</td>
<td>High</td>
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<tr>
<td>2. Macroeconomic</td>
<td>High</td>
</tr>
<tr>
<td>3. Sector Strategies and Policies</td>
<td>Substantial</td>
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<tr>
<td>4. Technical Design of Project or Program</td>
<td>Moderate</td>
</tr>
<tr>
<td>5. Institutional Capacity for Implementation and Sustainability</td>
<td>Substantial</td>
</tr>
<tr>
<td>6. Fiduciary</td>
<td>Substantial</td>
</tr>
<tr>
<td>7. Environment and Social</td>
<td>Substantial</td>
</tr>
<tr>
<td>8. Stakeholders</td>
<td>Substantial</td>
</tr>
<tr>
<td>9. Other</td>
<td>Moderate</td>
</tr>
<tr>
<td><strong>Overall</strong></td>
<td>Substantial</td>
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</tbody>
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## ANNEX 1: POLICY AND RESULTS MATRIX

<table>
<thead>
<tr>
<th>Prior Actions and Second Tranche Release Conditions under DPF1</th>
<th>Prior Actions under DPF2</th>
<th>Indicative Triggers under DPF3</th>
<th>Results Indicator</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Pillar 1. Maximizing finance for development</strong></td>
<td></td>
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<tr>
<td>1.1 Promoting public-private partnerships</td>
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<tr>
<td><strong>Prior Action #1:</strong> Parliament has approved the PPP Proclamation, and MoF has issued the PPP Directive to establish a regulatory framework and institutions that manage fiscal risks and enhance transparency, fairness, and long-term sustainability in implementing privately financed projects.</td>
<td><strong>Prior Action #1:</strong> The PPP Directorate General issues PPP Implementation Guidelines with the required procedures and authorizations to undertake PPP transactions, including an assessment of the contingent liabilities related to the sovereign contractual obligations.</td>
<td><strong>Indicative Trigger #1.2:</strong> (i) The Council of Ministers adopts and submits to Parliament an amendment to Proclamation No. No. 299/2002 on Environmental Impact Assessments that strengthens the federal ESIA system, including by restoring independent authority to review, approve, and enforce ESIAs. (ii) The Environment, Forests, and Climate Change Commission promulgates a directive on public consultations in ESIs.</td>
<td>Proportion of PPP contracts for which more than 4 bids are received: Baseline (2018): 0% Target (2021): 80%</td>
</tr>
<tr>
<td><strong>Prior Action #2:</strong> The Recipient’s Council of Ministers has approved a multi-year electricity tariff increase framework with a detailed implementation schedule to improve cost recovery while protecting the poor.</td>
<td><strong>Prior Action #2:</strong> Under supervision of the EEA, the EEU and MoWIE have announced the implementation of a second electricity tariff increase under the multi-year electricity tariff increase framework in December 2019.</td>
<td><strong>Indicative Trigger #2.2:</strong> (i) Under supervision of the EEA, the EEU and MoWIE announce the implementation of a third increase under the tariff framework in December 2020. (ii) Under the approved restructuring of EEP’s debt, the MOF completes the takeover of EEP bonds held by CBE. (iii) Pursuant to the institutional reform roadmap, the power sector agencies implement the first year’s actions.</td>
<td>Power sector has achieved cost recovery: Baseline (FY2018): 31% Target (FY2022): 75%</td>
</tr>
<tr>
<td><strong>Prior Action #3:</strong> The Government’s Macroeconomic Committee has approved a phased restructuring of EEP’s debt in the power sector and the</td>
<td></td>
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<td>Power sector losses (commercial and technical): Baseline (FY2018): 23% Target (2021): 18% Power sector debt service coverage ratio:</td>
</tr>
</tbody>
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49 Cost recovery is defined here based on the utilities’ net income in their audited financial statements, i.e., including operating cost, borrowing cost, and other cost items captured in the income statements.

50 Targets for cost recovery and debt service coverage ratio will be updated after the approval of the debt restructuring plan.

51 Targets for cost recovery and debt service coverage ratio will be updated after the approval of the debt restructuring plan.
### 1.3 Introducing competition in the logistics sector to reduce costs and improve efficiency

**Prior Action #3:** The Ethiopia Investment Board has lifted restrictions limiting logistics sector to domestic participation only and permitted minority foreign investment in critical logistics services (including freight forwarding and shipping agency services, warehousing, cargo consolidation, and packaging) to foster competition.

**Prior Action #4:** The Government’s Macroeconomic Committee has issued a decision that encourages competition by allowing private sector, including foreign firms, to access and offer value-added logistics services in dry ports.

**Indicative Trigger #3.2:** The Ethiopia Revenue and Customs Authority launches the Electronic Single Window system for regulatory procedures in trade clearance.

<table>
<thead>
<tr>
<th></th>
<th>Baseline (FY2017): 1.84</th>
<th>Target (FY2022): +0.5</th>
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<tbody>
<tr>
<td>Number of days to clear import by customs:</td>
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<tr>
<td>Number of days to clear export by customs:</td>
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<tr>
<td>Baseline (2018): 5.5</td>
<td>Target (2021): 4</td>
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<tr>
<td>FDI in logistics sector (cumulative):</td>
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<tr>
<td>Percentage of type of License, Permit, Certificate, or Other requirements that are automated under the Electronic Single Window:</td>
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<td>Baseline (2018): 0%</td>
<td>Target (2021): 66%</td>
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### 1.4 Introducing competition and foreign participation in the telecom sector to improve connectivity

**Second Tranche Release Condition #1:**
Council of Ministers has approved the establishment and constitution of an independent regulator for the telecom sector.

**Prior Action #5:** (i) The Prime Minister has appointed the Board for the ECA.
(ii) The ECA has convened a public consultation on the selection process for new telecom operator licenses.

**Indicative Trigger #4.2:** Competitive selection of new telecom operators is completed, and licenses are awarded by the Ethiopian Communications Authority.

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<tr>
<td>Number of licensees operating in Ethiopian telecom sector:</td>
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<tr>
<td>Price of 1GB of data per month as % of GDP per capita:</td>
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<td>Baseline (2018) 12.6%</td>
<td>Target (2021): 5%</td>
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<td>Usage of mobile money, share of age 15+ population:</td>
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<tr>
<td>Baseline (2017): 0.32%</td>
<td>Target (2021): 5%</td>
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## 2.1 Streamlining business regulations to foster private sector development

**Prior Action #4:** The Ministry of Trade has reduced the number of licensing categories by half and eliminated the requirement for annual competence certificates for at least 70 percent of trade-licensing categories, to reduce the regulatory burden and simplify business entry, affecting over one million businesses.

**Prior Action #6:** The Council of Ministers has approved for submission to Parliament a draft Investment Proclamation enabling foreign participation in a broader set of economic sectors (shift from positive to negative list of sectors).

**Indicative Trigger #5.2:** (i) The Council of Ministers adopts and submits to Parliament a new commercial code modernizing the legal framework for the private sector in the areas of minority investor protection, insolvency, and reorganization. (ii) The Council of Ministers adopts and submits to Parliament a new proclamation on Alternative Dispute Resolution. (iii) The Council of Ministers adopts and submits to Parliament a comprehensive proclamation on e-commerce and the e-payments regime in Ethiopia.

**Results Indicator:** Share of business activities required to obtain certificates of competence:
- **Baseline (2018):** 100%
- **Target (2021):** 10%

**Number of investment permits issued in sectors previously closed to foreign investors**
- **Baseline (2018):** 0
- **Target (2021):** 20

## 2.2 Removing constraints to access to credit in private sector

**Prior Action #7:** The Board of the NBE has repealed the 27 Percent Rule.

**Credit to the private sector as a share of total credit**
- **Baseline (2018):** 30%
- **Target (2021):** 37%

## 2.3 Establishing the government securities market

**Prior Action #8:** The Board of the NBE has approved financing through instruments at market-determined rates, and the first auction of treasury bills was conducted in December 2019.

**Indicative Trigger #7.2:** The Ministry of Finance publishes a calendar of auctions of treasury bills at market-determined rates for FY21.

**Share of instruments at market rates in the total stock of government bonds**
- **Baseline (2018):** 0
- **Target (2021):** 10%
## Prior Actions and Second Tranche Release Conditions under DPF1

<table>
<thead>
<tr>
<th>Prior Actions and Second Tranche Release Conditions under DPF1</th>
<th>Prior Actions under DPF2</th>
<th>Indicative Triggers under DPF3</th>
<th>Results Indicator</th>
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<tbody>
<tr>
<td><strong>Pillar 3. Enhancing transparency and accountability</strong></td>
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<tr>
<td><strong>3.1. Promoting citizen engagement and social accountability</strong></td>
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<td><em>Second Tranche Release Condition #2:</em> The Council of Ministers has approved for submission to Parliament a draft CSO Proclamation to promote greater CSO and citizen participation in the development process.*</td>
<td><em>Prior Action #9:</em> The Council of Ministers has approved for submission to Parliament a Federal Administrative Procedure Proclamation that provides for routine consultations on draft Directives, subject to specified exemption(s), and consultation is one of the pre-requisites for adoption of Directives.</td>
<td><em>Indicative Trigger #8.2:</em> (i) The Council of Ministers has approved regulations to implement the new Access to Information Proclamation to provide citizens with greater access to information and data held by government ministries and agencies in Ethiopia.</td>
<td>Percentage of CSOs registered by the Ethiopian Charities and Societies Agency under the new Proclamation: Baseline (2018): 0% Target (2021): 80%</td>
</tr>
<tr>
<td><strong>3.2 Improving SOE management, transparency and accountability</strong></td>
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<td><em>Prior Action #5:</em> The Council of Ministers has approved Guidelines for privatizing SOEs that establish the objectives and principles of the privatization process, clear institutional responsibilities for managing private participation in strategic SOEs, and transparency and accountability provisions.*</td>
<td><em>Prior Action #10:</em> (i) The Council of Ministers has issued Regulation No. 445/2019 authorizing the creation of a holding entity for SOEs. (ii) The Council of Ministers has approved for submission to Parliament a draft Privatization of Public Enterprises Proclamation, which sets out a framework for the privatization of public enterprises.</td>
<td><em>Indicative Trigger #9.2:</em> The Council of Ministers adopts and submits to Parliament a Revised Public Enterprise Proclamation reflecting international good practice on state ownership, level playing field, governance structures and policies, financing, debt management, performance management, transparency, and disclosure requirements.</td>
<td>Number of SOEs that have published on their website timely annual audited financial statements prepared using IFRS: Baseline (2018): 1 Target (2021): 9</td>
</tr>
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ANNEX 2: IMF RELATIONS ANNEX

PRESS RELEASE NO. 19/486

IMF Executive Board Approves US$2.9 Billion ECF and EFF Arrangements for Ethiopia

December 20, 2019

- IMF Board approves SDR 2.1049 billion (about US$2.9 billion) ECF and EFF arrangements for Ethiopia.
- The three-year financing package will support the implementation of the authorities’ Homegrown Economic Reform Program.
- The Fund-supported program aims to help authorities reduce external imbalances, contain debt vulnerabilities, lift financial repression, increase domestic resource mobilization which will also help devote adequate resources to pro-poor spending.

On December 20, 2019, the Executive Board of the International Monetary Fund (IMF) approved three-year arrangements under the Extended Credit Facility (ECF) and the Extended Fund Facility (EFF) for Ethiopia in an amount equivalent to SDR 2.1049 Billion (around 700 percent of quota or about US$2.9 billion) to help the country implement their ‘Homegrown Economic Reform Plan’ to maintain macroeconomic stability and improve living standards.

The program aims to support the authorities’ implementation of their ambitious reform agenda and catalyze concessional donor financing. The Executive Board’s decision will enable an immediate disbursement equivalent to SDR 223.85 million (about US$308.4 million). The Executive Board today also concluded the 2019 Article IV consultation with Ethiopia. A press release will be issued separately.

At the conclusion of the Executive Board’s discussion, Mr. David Lipton, First Deputy Managing Director and Acting Chair, stated:

"A decade of rapid growth, underpinned by strong policies, has supported a reduction in poverty and improved living standards in Ethiopia. However, the public investment-driven growth model has reached its limits. The authorities have prepared a Homegrown Economic Reform Plan to address macroeconomic imbalances, reduce external and debt vulnerabilities, phase out financial repression, and lay the foundation for private sector-led growth.

“A financial arrangement with the Fund will support the authorities’ plan, helping to catalyze concessional financing from other development partners. The program aims to address foreign exchange shortages and external imbalances; reform state-owned enterprises (SOEs); safeguard financial stability; and strengthen domestic revenue mobilization.

“Monetary tightening and reforms will help rein in inflation, facilitate credit to the private sector, and strengthen competitiveness. Greater exchange rate flexibility, supported by
tighter monetary policy, will durably address foreign exchange shortages and narrow the spread between the official and parallel market rates. Further efforts are needed to modernize the monetary policy framework and deepen financial inclusion.

“Fiscal consolidation and reforms aim to reduce debt vulnerabilities, increase revenue, and strengthen expenditure efficiency while protecting social and development spending. Improving the financial positions of SOEs and strengthening their governance and oversight will also be critical to ensuring debt and financial stability.

“With strong ownership and full implementation of reforms, the authorities’ economic plan should eventually improve macroeconomic outcomes and lower external vulnerabilities. High priority is placed on removing constraints to private investment and improving the business climate, setting the stage for an acceleration in private sector-led growth.”

Annex

Recent Economic Developments

Ethiopia has sustained high economic growth over the last decade. Substantial progress on reducing poverty and improving social indicators has also been noteworthy. In 2018/19, real gross domestic product (GDP) is estimated to have grown by 9 percent, driven by manufacturing and services. However, the performance of goods exports remained weak and foreign exchange shortages persisted. Policies appropriately targeted at containing public investment and debt contributed to a further narrowing of the current account deficit to 4.5 percent of GDP and a reduction in public and publicly-guaranteed debt to 57 percent of GDP (from 59.5 percent). Inflation remained elevated in double digits, largely due to higher food prices, though non-food inflation has also been trending upward. While revenues came in below target, cuts in expenditure contained the fiscal deficit to 2.5 percent of GDP, below budget.

Program Summary

The public investment-driven model of the past two decades has delivered impressive economic and social outcomes but has resulted in growing vulnerabilities. To tackle these vulnerabilities, the authorities have recently unveiled an ambitious Homegrown Economic Reform Plan, (HERP), for which they are seeking Fund financial support. The new Fund-supported program is well-aligned with the HERP and designed to address macroeconomic imbalances and implement structural reforms to upgrade policy frameworks and facilitate the shift from public sector to private sector-led growth.

The program will:

• **Address the foreign exchange shortage** and the transition to a more flexible exchange rate regime. A further rationalization of import-heavy public investment projects, combined with reforms to boost FDI and exports, will address external sector vulnerabilities. Greater exchange rate flexibility over time will eliminate the gap between the official and parallel market and boost competitiveness.

• **Strengthen oversight and management** of state-owned enterprises (SOE) to contain debt vulnerabilities. Maintaining strict control of SOE borrowing will contribute to continued reduction
of debt vulnerabilities. Publication of a consolidated financial performance for SOEs based on financial statements will increase transparency and accountability.

- **Boost domestic revenue mobilization and increase expenditure efficiency to create space for reducing poverty and infrastructure spending.** Revenue reforms on both the policy and administration front are designed to increase the tax to GDP ratio. These reforms, combined with efforts to strengthen public financial management, including increasing the efficiency of public investment, will ensure that infrastructure and social spending needs are met without undermining debt sustainability.

- **Reform the financial sector** to support private investment and modernize the monetary policy framework. Reducing financial repression and developing the financial sector will increase private sector access to credit. A phasing out of central bank direct financing of the budget and development of short-term market-based instruments are essential to create a monetary policy framework that is well-equipped to consistently achieve inflation objectives.

- **Reinforce the supervisory** framework and financial safety nets. Progress towards strengthening regulatory and supervisory standards will contribute to continued financial stability. Approval and implementation of regulations for deposit insurance will be an important step to bolster financial safety nets.

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ANNEX 3: LETTER OF DEVELOPMENT POLICY

Letter of Development Policy

February 19, 2020

Mr. David Malpass
President
World Bank Group

Federal Democratic Republic of Ethiopia
Support Policy Reforms
(2018 – 2020)
Letter of Development Policy for DPO 2

Dear President Malpass,

Ethiopia has made substantial progress and transformational strides in the past fifteen years. Economic growth picked up and entered a new growth trajectory in 2004, averaging over 10 percent per annum since then. The accelerated economic growth was largely inclusive and translated into improved living standards. Poverty and unemployment substantially declined, while access to essential social services expanded. Health outcomes improved as reflected in the decline of child mortality by 60%, and maternal mortality by 52% between 2000 and 2016.

From governance and domestic political landscape point of view, the last few years have seen new phase of challenges and opportunities related to democratization and popular participation in the overall governance of the country. In spite of the impressive progress in economic growth and development, poverty and unemployment remain high, causing growing discontent and malaise particularly among the youth. In response to these emerging challenges, the ruling party nominated a new Prime Minister, Dr. Abiy Ahmed, in March 2018, thereby ushering a new era of change and transformation fitting for the coming years.

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Minister
The Ethiopian Government, led by Prime Minister Dr. Abiy Ahmed, started a wave of reform actions that started after spearheading several consultations with different communities. The Prime Minister has shown commitment to demonstrate gender equality and public sector effectiveness as seen by appointing historical gender balanced cabinet and bringing highly qualified officials in to top political positions. There is an opening of the political space with opposition parties coming back from exile to take part in the political process. Freedom of expression is also improved with several private and state media reporting on political issues without any interference. The government is committed to ensure political stability, to hold national elections in 2020 and to institutionalize democracy and rule of law while increasing civil society engagement. These are expected to consolidate the democratization process, broadening the political space to sufficiently accommodate various views and opinions in shaping the future of the country.

Yet another significant development in the recent period of Ethiopia is the reengagement with Eritrea and deepening of cooperation with other neighboring countries. These measures, while aimed at ensuring regional peace and stability, are essential to creating conducive conditions for economic prosperity. As you may know, countries in the horn have recently endorsed the Horn of Africa Initiative and agreed to take forward the discussion on fostering economic integration and regional cooperation in the Horn of Africa with the support of the World Bank, European Union and African Development Bank. A stable and prosperous sub-region is a priority for Ethiopia and all countries to deepen the economic integration as mutually reinforcing drivers which can transform the future of the sub-region. In turn, deeper regional integration is vital for economic transformation and for creation of jobs that is a priority for all our countries. The development contexts vary significantly between countries of the sub-region and, while each country will chart its own course, this regional initiative allows the space to come together and act collectively keeping the best interests of all countries in mind.

On the economic reform side, since in office, the new leadership has been taking various initiatives aimed at strengthening the role of the private sector in driving growth. As such, the ongoing comprehensive policy reform is intended to enhance a greater private sector participation in the economy through measures to encourage private investment while the role of the public sector also continues in strategic areas.

One of the major areas of transformation announced by the new government soon after assuming the leadership was its intention to privatize partially and fully major state-owned enterprises (SOEs). This major policy announcement publicized on June 5, 2018 aimed at sustaining inclusive and rapid growth, as well as accelerating structural change. In this regard, the first operation of DPF was fundamental in supporting the acceleration of this and other government reforms at an early stage.
In September 2019, with an objective of leveraging the achievements of the past decade for high quality growth while overcoming emerging challenges and creating new opportunities, the government unveiled the Homegrown Reform Agenda that will guide the reforms that started earlier. The reform consists of structural changes aimed at removing business constraints, opening sectors to private sector competition, and enhancing transparency and accountability in State-Owned Enterprises, coupled with macroeconomic measures that will help in correcting imbalances and safeguarding financial stability.

The Ethiopian government is committed to guide its public finances through its newly introduced Public Finance Management (PFM) Reform Strategic Plan (2018-2021). Under one of the nine strategic goals of the PFM reform strategy, the government is committed to enhance revenue mobilization and pursue a prudent expenditure stance such that within a reasonable time frame it balances its revenues and expenditures. In parallel, after putting in place required institutional arrangements, the country will ensure that the pricing of the government’s domestic financing of its budget evolves to market determined rates.

Consistent with the country’s fiscal policy, the government has continued to exert more effort to strengthen its domestic revenue mobilization, achieve more effective and efficient allocation and utilization of public resources as well as maintain fiscal deficit-consistent with its macroeconomic objectives.

Budget transparency was one of the areas where the Ethiopian government has implemented various reform actions to enhance citizen participation in the budgetary process. As a result, financial transparency and accountability has now become a mainstream aspect of the public finance landscape in Ethiopia. To further deepen the reform, the government will introduce measures that enable to disclose budget execution reports on a regular basis through official websites. The government has also committed to a new set of transparency initiative concerning state-owned enterprises. Accordingly, the Ethiopian government will take measures that enable the major SOEs to disclose and publish their audited financial accounts regularly through official websites by which few of them including Ethio-telecom and Ethiopian Airlines have already started.

On debt management, the Ethiopian government is committed to implement intensified vigilance and screening of new loans until public debt related metrics of the economy comest down to acceptable levels. To ensure full transparency on new loan commitments and debt, MoF is providing a quarterly reporting to the World Bank on a regular basis. Currently, the reform has gone well beyond what is discussed under the DPO, as Ethiopia has confirmed its commitment to the New York Convention and has amended the anti-money laundering law.
With regard to improving exports, commodity export will continue to pose challenges on the current account. Due to drop in global prices and competitiveness issues, Ethiopia's export growth continues to experience major difficulties. Although some efforts to increase volume of exports compensated for the loss, overall export earnings declined as percentage of GDP for most of the last several years. The government recognizes that Ethiopia is vulnerable to price swings as unprocessed agricultural products dominate its exports. For this reason, the country has been working to diversify its exports, with increased focus on manufacturing and energy export. Renewed efforts in accelerating value addition is also part of the broader strategy. The Government intends to tackle the institutional and structural bottlenecks to productivity and job creation and implement sectoral reforms in key strategic sectors. There is a plan to accelerate ongoing efforts to allow privatization in key sectors; create a secure and predictable market access to exports, including by expediting accession to the World Trade Organization (WTO); and improving the efficiency of domestic markets for goods and services by removing barriers to entry, enforcing the Competition Law, and improving the efficiency of the commodity and product market supply chains.

Moving forward, the government is committed to these reform areas by prioritizing structural economic transformation, and accelerated and inclusive economic growth, which help to create more jobs both in rural and urban areas and build resilience of the economy to climate and market risks. More importantly, the Homegrown Reform Agenda will pursue economic transformation that will sustain the economic growth and improve development indicators. Poverty is still a major challenge for the country with millions living below the poverty line. For this reason, the government will ensure that inclusive development strategy supported by a sustainable safety nets system will anchor its transformational agenda.

The second Growth and Competitiveness DPF 2 will be important in supporting the reform agenda initiated during DPF 1 and additional key strategic reforms. The reforms and policy measures tied to the DPF 2 prior actions are explained below.

Promoting public-private partnerships

In order to develop a successful PPP program in the country, the government, through its PPP policy has selected the energy and transport sectors as priorities for PPP implementation. The government has already enacted Public Private Partnership regulatory framework and has introduced needed institutional set ups such as the establishment of the PPP Directorate General in the MOF. The Government is now implementing PPPs with four PPP projects completing financial closure. The government will continue with its restrained stance regarding the financing of new public infrastructure investments through its budget and SOEs financing. In doing so, it will promote increased role for private sector participation in the provision of infrastructure and
energy to help address its huge energy and infrastructure deficits, and thereby also sustain its growth and transformation agenda.

Due to the complexity of PPP projects, the Ethiopian government is putting in place adequate capacity both at the PPP Directorate within the Ministry of Finance and contracting authorities. The government is also using external expertise to support the government institutions involved in PPP projects processing, including transaction advisers. A key element of the screening and assessment of PPP projects will be their implication on public finances. As required by the PPP law, the Ethiopian government will ensure projects selected for implementation through the PPP modality will not impose significant contingent liabilities on the public sector.

For this reason, the PPP Directorate General has issued PPP implementation guideline with the required procedures to undertake PPP transactions, including an assessment of the contingent liabilities related to the sovereign contractual obligations.

**Power Sector Reform**

Another important structural reform that supports sustained growth and transformation concerns the power sector reform. Ethiopia is currently one of a few countries globally which produces more than 95% of its electricity from renewable sources, including water, wind, solar, and geothermal. Due to a strategic prioritization of the energy sector in the country’s development plan, Ethiopia was able to expand its energy production capacity by ten-fold in the past 25 years, albeit from a low-base. This same period has coincided with rapid growth in demand for electric energy, which continues to grow at more than 20% per year.

During this time, cost of providing electricity has been rising due to several factors. Meanwhile, Ethiopia’s electricity tariff is among the lowest in the World and remained nominally constant over the past decade. For this reason, the Ethiopian government undertook a comprehensive electricity tariff study, which recommended cost-reflective tariff adjustment. A multi-year electricity tariff reform was approved in 2018 with the aim of improving cost recovery, and with the expectation it will also encourage private investment in the generation of renewable electricity for domestic supply and exporting. So far, two tariff increases have been implemented, in December 2018 and December 2019, supported by DPF1 and DPF2 in this series. The new adjustment considered various consumer categories and designed tariff structures.

While tariff increases will improve cost recovery and utility results going forward, there is also a need to restructure the stock of electricity sector liabilities accumulated in previous years. In this regard, in November 1, 2019, the Government’s Macroeconomic Committee has endorsed a phased restructuring of utility debt in the power sector. As a first step under this restructuring, the government has swapped loans on lent to Ethiopian Electric Power Corporation into equity and is assessing the restructuring of part of the remaining debts of the sector to more favorable
terms. Going forward, the government is committed to optimize future capital expenditure on energy transmission and distribution to ensure the financial sustainability of the sector.

The power sector in Ethiopia is facing not only financial sustainability problems, but also institutional, performance and regulatory issues. The government understands that sector debt restructuring, and performance improvement are essential parts of achieving the sector reform. To implement in a coordinated and harmonized manner power sector reform, the government is currently working on power sector roadmap. It will be an important guide to address areas that affect the sustainable development and future of the sector, in a coordinated and harmonized manner.

**The Logistics Sector Reform**

In recent years, imbalances in the external sector have become a major challenge for the country. The trade imbalance portion is partly explained by the underperformance of the export sector. In this regard, inefficiencies in trade logistics represent a major challenge to Ethiopia’s external competitiveness. Ethiopia’s logistics sector appears to be considerably behind those of competitor economies and other land-locked countries in Africa.

To enable the delivery of integrated response to trade logistics challenges, the Ethiopian government has approved a National Logistics Strategy in August 2018. The strategy provides a framework for subsequent actions that will facilitate efficient import-export trade – including faster clearance of cargo from sea ports and dry ports; reduce excess cost and delays encountered by private and public operators in the process of using logistics facilities; to provide an improved legal basis for inter-sectoral coordination and modernized delivery of logistics services; and through introducing a clear vision about the future direction of logistics services in Ethiopia, enable stakeholder to design appropriate solution and modernization which leverages technology to provide competitive solutions.

Beyond the broader policy frameworks provided by the National Logistics Strategy, we have worked to concretely address some regulatory constraints that prevented the participation of international operators in the sector. Accordingly, in August 2018, to allow international operators to participate in the provision of services including bonded warehouse, consolidation and deconsolidation services and allow joint venture participation of international logistics service providers.

Consequently, in November 2019, the Government’s Macroeconomic Committee has made a decision that encourages competition by allowing private sector, including foreign firms, to access and offer logistics services in existing dry ports, and to own and operate new dry ports. This significant shift of opening of the logistics sector is expected to attract FDI and help develop

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Minister
new services in the logistics sector. We expect a positive impact on improving the performance of the logistics sector that ultimately will contribute to increase exports.

Moving forward, the government is committed to deepen the sector reform, as reflected in the Homegrown Economic Reform Agenda that prioritizes enhancing logistics efficiency and investment in logistics infrastructure, as key.

**Privatization and governance of State-Owned Enterprises (SOEs)**

Ethiopia is committed to improving transparency and accountability of its SOEs, to improve their efficiency and their ability to provide high quality public service delivery. In this regard, in January 2019 PEHAA was established as a supervisory agency for strategic SOEs. Strengthened oversight is expected to further improve both SOE results and reporting standards. The Government is committed to have at least nine strategic SOEs publishing annual audited financial statements under IFRS by end of 2021. The Public Enterprise Proclamation is drafted and 2nd round stakeholder consultations is planned to be organized in the coming few weeks. The proclamation is expected to be approved by the Council of Ministers by March 2020.

In addition to the SOE governance and management reform, the government committed to undertake structural reforms including partial or full privatization of selected SOEs with the overarching objective of advancing the country’s growth and structural transformation while promoting private sector development. The recent government policy decision to privatize state-owned enterprises (partially and fully), has as its primary objective to help sustain the robust economic growth the country witnessed for over a decade and half, and accelerate structural transformation of the economy. For this reason, the government intends to guide the privatization process in such a way that it will be supportive of the economic growth and transformation agenda set for the country.

More specifically, the goals of the privatization drive are set as follows: (i) pursue a privatization program that will elevate the inclusive and robust economic growth of the last decades into a new phase, as well as accelerate structural economic transformation; (ii) support the country’s transformation through leveraging additional development finance to be generated from the privatization of the SOEs; (iii) the promotion of private sector development through creation of additional business opportunities and signaling or confidence effect of these unprecedented privatization drive to the private sector; (iv) transform the SOEs themselves, through a roadmap that modernizes corporate governance, strengthens the regulatory environment, and structures the market; (v) enhance the viability and competitiveness of SOEs, so that through stronger creditworthiness they will be in a position to access both domestic and external financing on their own balance sheet. In this regard, while Ethiopia has emerged as one of the biggest investment destination on the African continent in the past few years, the recent policy announcement to
privatize big and strategic SOEs is expected to further boost the country's image as an attractive destination for private capital.

The government will execute the privatization program with utmost transparency, accountability and integrity. A comprehensive policy and regulatory framework that support a competitive market structure and protection of public interest will be put in place to help deliver on the key goals of the privatization program.

The Government has already taken concrete actions towards implementing the privatization policy pronouncements. First, it has developed a guideline that outlines the governance arrangements for the privatization program. Second, a new Privatization proclamation that provides a framework for the privatization of SOEs has been approved by the Council of Ministers and submitted to Parliament. The proclamation is expected to be approved by the Parliament by March 2020.

This new regulatory framework will be applied when implementing planned privatizations. The state-owned enterprises in priority sectors for privatization are telecom, sugar, energy, logistics, and railway industries. In the sugar sector, the reform aims at full privatization of 13 factories and an overall sectoral reform to augment the sugar market. A technical assessment of 13 factories, the valuation for all factories is completed while the environmental and social impact assessment is underway with planned completion timeline of March 2020. The bid document is also under preparation. Overall, to enhance the sugar market in the country, a national sugar sector policy is developed and ready for stakeholder consultation. In the energy sector, the pre-privatization assessments are underway. The power sector roadmap is approved, and the restructuring of the Power enterprise’s debts is ongoing.

**Telecom Sector Reform**

In 2018 the Prime Minister announced the Government’s intention to open the telecommunication market to competition by issuing two additional licenses for telecommunications services operators and by partially privatizing Ethio-Telecom. Subsequently an independent regulator for the sector, the Ethiopian Communications Authority (ECA) has been established, and the seven-members for ECA board management have been appointed. Overall capacity building measures are being taken, including office set up and recruitment of relevant positions. A Draft regulatory framework is under preparation and is expected to be completed by March 2020.

An expression of interest has been issued by the Ministry of Finance to hire a transaction advisor for Ethio Telecom to undertake the necessary assessments and preparation for the privatization. Following a shortlisting process, a request for proposal was issued and the selected firm is expected to commence work by the end of February 2020. The Government has engaged an
international financial advisor for the award of the license to the envisaged two operators. The selection process is expected to be completed within the timeline of June to September 2020. On October 22, 2019, ECA launched a public consultation on the regulatory framework for the sector and of the process for awarding two new full-service licenses. The reform of the telecoms sector aims to fully utilize technology to usher the next chapter of the rapid economic growth of the country. After the Public Consultation ended, on November 22, 2019 feedback was received from stakeholders and this will be the basis for a decision on the way forward by the ECA.

**Investment Climate Reforms**

Ethiopia’s private sector competitiveness is very low with deteriorating doing business ranking. To solve this, the government has been taking various initiatives to slowly de-risking the business environment and crowd in more private sector participation. In December 2018, Prime Minister Abiy Ahmed launched a national flagship reform initiative targeting to be among the top 100 ranking countries in 3 years. A National Doing Business Steering Committee is established and meets every month to monitor progress. To date, 8 new laws and 40 procedural and administrative reforms were enacted with the aim to reduce the time, cost and procedural hurdles businesses face in their life cycle (from startup to operation and exit). These reforms were communicated with the private sector through regular consultation workshops and feedback loops created to ensure effective implementation.

In November 1, 2019, the Board of Investment has approved a new Commercial Code to modernize the overall legal framework for business in Ethiopia with the intention to protect minority shareholders and provide insolvency rules that allow rehabilitation of the debtor’s business. It will be an important step to reduce the regulatory burden on domestic and foreign owned businesses and together with reforms linked to investment and competition proclamation are expected to contribute to the increase in overall investment including FDI.

The Government of Ethiopia, in its plan to sustain the country’s positive growth, has adopted a strong focus on encouraging and expanding investment (both FDI and domestic) to foster industrialization, accelerate the economic development of the country, increase foreign exchange earnings through export diversification and import substitution and create ample employment opportunities for Ethiopians so as to improve their living standards. This set agenda for a structural reform provides a clear window of opportunity to launch broad and deep reforms that can help Ethiopia enhance its competitive position and catalyze private sector development.

To that effect, the Ethiopian Investment Commission (EIC) has been carrying out a legal reform of the existing Investment legislations of Ethiopia i.e., Proclamation 769-2012 (as amended) and regulation 270-2012 (as amended). The revision of the investment law has been dictated by the need to revisit investment areas open to the private sector as well as to modernize the
investment regulatory and administrative framework, align the investment legal regime with recent changes in economic policy priorities, consolidate protracted rules on investment, adopt best practices for efficient investment administration/service provision including One-Stop-Services and devise a faster and more transparent investor grievance handling mechanism.

The new investment proclamation that replaces the “positive sector listing approach” which lists all sectors open for FDI and closes the remaining sectors, with a “negative sector listing approach” which lists sectors fully or partially restricted for FDI and opens all remaining sectors has already been endorsed by the Council of Ministers and approved by the Parliament on January 30, 2020. It is expected to be published on the Negarit Gazette over the coming few weeks.

The Government is also committed to tackle the difficulties that some companies are facing, including delays of payment and complications in the implementation of fiscal legislation and agreements by implementing a follow-up mechanism that will convene on a regular basis in the presence of representatives of the relevant public entities and the private sector to address those issues.

Financial Sector Reform

The Banking sector in Ethiopia remains one of the drivers of growth in the country. It is stable, well-capitalized and highly profitable. However, due to the slow pace of financial sector development in the country, the banking modernization agenda is lagging. The Ethiopian government recognizes that the economic transformation agenda has to be supported by modern financial sector. Towards this end, the National Bank of Ethiopia (NBE) has initiated the preparation of a financial sector roadmap. The roadmap will lay out Banking sector reforms, which will be aligned with Ethiopia’s WTO accession agenda. The government is keen to complete the accession negotiations in the next two years. Preparations are underway to submit the required documents to conduct the fourth working party meeting before the end of the year.

As prioritized in the Homegrown Reform Agenda, the government planned to undertake the following reforms in financial sector in short and medium term. This includes modernize the operations of the two State Owned Banks to the level of industry best practices; upgrading NBE’s financial regulatory framework to international standards; enforcing the regulatory rules uniformly across banks; improving financial access through developing capital and financial markets. In particular, the reform measures will include developing a competitive and well-functioning T-bills market; upgrading the financial market infrastructure through complete phasing out the NBE bill and facilitating the development of inter-bank money markets; establishing secondary bond markets and a stock exchange market in collaboration with the private sector and with technical assistance from development partners; and supporting the development of mobile banking to promote financial inclusion.
Effective November 2019, the NBE has repealed the 27 percent rule that required private commercial banks to acquire central bank bonds wherever they lent to customers. The removal of the 27 Percent Rule is expected to allow the private sector to continue enjoying healthy credit growth. The Ministry of Finance has officially announced the T-Bill auction for concerned bodies including media followed by public outreach on November 30, 2019. The previous auction schedule of every week on Wednesday was changed to happen in two weeks interval on the same date. Accordingly, the NBE has officially started auctions of treasury bill at market-determined rates as a new policy instrument. To date, six rounds of auction of Treasury Bill equivalent of ETB 2.94 billion (including 28 and 91-day bills) were conducted; the first one being on December 4, 2019. All the bids received positive response and registered an average weighted interest rate below the deposit rate. Furthermore, the SoE banks are undertaking International Financial Reporting Standards (IFRS) compliance audit.

Transparency and Accountability

In the end, transparency and accountability is among the areas the new administration is focusing to implement in the conduct of public affairs and access to information by citizens, civil society, the private sector, and media to create a feedback loop which is critical for strengthening service delivery.

For this reason, budget transparency was one of the areas where the Ethiopian government has implemented various reform actions to enhance citizen participation in the budgetary process. As a result, financial transparency and accountability has now become a mainstream aspect of the public finance landscape in Ethiopia. As stated on this document, the government is also introducing measures that enable to disclose budget execution reports on a regular basis through official websites.

The role of Civil Society Organizations (CSOs) in supporting the transparency and accountability of the public sector is another area of reform. In February 2019, by taking into account the views and opinions of stakeholders, the Parliament adopted a revised CSO Law that supports greater citizen participation in the development process. With this shift, the highly criticized restrictions on areas of operation and source of funding have been lifted for CSOs engaging in advocacy and human rights works. CSOs can now engage in any lawful activity and obtain funding from any lawful source.

The Council of Ministers has approved a Federal Administrative Procedure Proclamation in November 2019 and it subsequently ratified by the Parliament. The proclamation is expected to be published in the Negarit Gazeta in the next few weeks. Following this, the government will prepare the implementation regulation that guarantees administrative justice by promoting culture of transparency and accountability through legally establishing a system of judicial review.
for persons who might be aggrieved by acts of administrative agencies, in their rule-making and
decision-making capacities.

Moreover, the Government has already initiated additional reforms in access to information
which are expected to promote proactive disclosure of reusable data which will increase
transparency and establish feedback mechanisms and ultimately improve service delivery. Both
the media law and access to information proclamation are under process and will be submitted
for the Council of Ministers once finalized.

In conclusion, the objective of the above set of extensive reforms and many others not
mentioned here is to sustain the rapid economic growth the country witnessed over the past
decade while laying the ground for economic transformation that leverages the increasing role
of the private sector. The government reaffirms its commitment to the reforms supported under
this series of DPF operations with the World Bank and other Development Partners. The
continued implementation of all actions envisaged under a Homegrown Reform Agenda will
enable the Government to deliver the targets set over the coming three – five years.
ANNEX 4: POVERTY AND SOCIAL IMPACT ANALYSIS

1. **Overall, the proposed DPF supports policy and institutional changes that are likely to have poverty-reducing effects in the medium term.** For example, telecom sector reform is expected to have direct and indirect poverty-reducing effects as discussed below. Other structural reforms are also likely to have positive poverty and distributional implications, although these may take some time to fully materialize. Improvements in the business and private sector environment through PPPs, a revised investment law, and SOE reform as well as the elimination of the 27 Percent Rule are expected to boost the establishment of new enterprises, lead to a higher level of foreign investment, and expand the volume of credit available to the private sector, while ensuring healthier public finances. This should create additional jobs which can to some extent help absorb the approximately 2 million young Ethiopians who enter the labor force each year.

2. **In the short term however, there are expected to be negative impacts that will need to be addressed.** The potential negative effects, particularly concentrated in the short-term, mainly consist of job losses in incumbent firms (including SOEs) when these firms are exposed to increased competition, a decline in households’ real purchasing power following energy tariff increases, and higher cost of government financing. The fact that the pay-offs of the reforms are expected to take several years to materialize while the negative effects will be frontloaded highlights the need for sufficient mitigation measures. These measures may include the expansion of urban safety nets to alleviate adverse effects of the reforms on the urban poor, active labor market programs to reduce the cost of job search and to up- or re-skill workers in case of lay-offs, provision of WB technical assistance to ensure optimal implementation of the reforms and ensure safeguards, and establishing systems to consult on and monitor the effects of the reforms. In addition, it will be important to design and implement an effective communication plan to maintain public support for the reforms. In general, wide stakeholder consultation and communication will be necessary to ensure continued local buy-in and to identify potential issues early-on. Table A4-1 summarizes the expected short – and longer-term effects of the proposed reforms and, in case of negative effects, briefly describes potential mitigation measures (in *italic*). The expected effects of each of the prior actions are discussed in more detail in the remainder of this Annex.
Table A4-1: Summary of expected poverty and social impacts of the prior actions

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<th>Prior Action</th>
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<td><strong>Prior Action #1:</strong> The PPP Directorate General has issued PPP Implementation Guidelines with the required procedures and authorizations to undertake PPP transactions, including an assessment of the contingent liabilities related to the sovereign contractual obligations.</td>
<td>Positive: No obvious impacts.</td>
<td>Positive: FDI investments in PPPs shall increase the fiscal space for the GoE as well as enhance the respective sectors performance, thus leading to better services for citizens and investments.</td>
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Prior Action #2: Under supervision of the EEA, the EEU and MoWIE have announced the implementation of a second electricity tariff increase under the multi-year electricity tariff increase framework in December 2019.

Prior Action #3: The Government’s Macroeconomic Committee has approved a phased restructuring of EEP’s debt in the power sector and the Ministry of Finance has implemented a conversion of loans on-lent to EEP into equity.

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<tr>
<td><strong>Prior Action #2:</strong> Under supervision of the EEA, the EEU and MoWIE have announced the implementation of a second electricity tariff increase under the multi-year electricity tariff increase framework in December 2019.</td>
<td>Positive: Tariff increases, which are needed to put the utility on the path to cost recovery, will have negative effects on household welfare in the short-run. Analysis shows that real consumption is expected to decrease by 4-5 percent across the distribution because of the tariff increases. While the direct effects are higher for the wealthier (they use more electricity), the indirect effects through higher food prices are more important for the poor (they devote a higher share of total consumption to food). <strong>Negative impacts on the urban poor (rural poor do not have access to electricity) can be partially mitigated through the planned scale-up of urban safety nets (P169943 currently being prepared).</strong></td>
<td>Positive: Better revenue collection rates and cost recovery will reduce the drain on the budget and increase fiscal space for the government to invest in electrification of currently non-connected areas (most of the rural areas). Meta-evaluations have found a high willingness to pay for rural electrification and benefits in terms of increased household incomes (through household businesses), reduced fertility, better health, and improved education outcomes for children (IEG, 2008). Better quality of electricity supply (fewer power cuts) is also expected to improve the operational efficiency and productivity of manufacturing firms.</td>
</tr>
</tbody>
</table>
Prior Action #4: The Government’s Macroeconomic Committee has issued a decision that encourages competition by allowing private sector, including foreign firms, to access and offer value-added logistics services in dry ports. Increased competition through private sector participation may put pressure on the public provider to become more efficient and profitable. This may in the short-term lead to layoffs in the public provider. Analysis shows that employees of public enterprises are likely to be highly employable (75 percent are university-educated and all have prior work experience). Short-term measures may nevertheless be necessary to support the job search of laid-off employees. More permanent measures may be required for the minority of SOE employees who are largely unskilled and older and may not be competitive in the labor market.

Prior Action #5: (i) The Prime Minister has appointed the Board for the ECA. (ii) The ECA has convened a public consultation on the selection process for new telecom operator licenses. A more competitive telecom market environment can be expected to have positive distributional effects. Simulations suggest that prices may decline by 25 percent in the short run, and by up to a factor of 3 in the long run. Lower prices and improved service provision will also have positive impacts on the extensive margin, with increased uptake particularly high for consumers in the middle of the distribution.
Prior Action #6: The Council of Ministers has approved for submission to Parliament a draft Investment Proclamation enabling foreign participation in a broader set of economic sectors (shift from positive to negative list of sectors).

New entrants can provide differentiated services (at potentially different prices) to consumers, expanding choice. For instance, in public transport new entrants can provide quicker routes and higher quality vehicles, geared towards consumers willing to pay a premium.

Increased competition from potentially more efficient entrants could lead to job losses in incumbent firms in the short run. Increased private sector investments will require strengthening of sector-specific regulations and its enforcement to avoid adverse downstream impacts (natural resources) as well as enhance protection in sensitive sectors (health, education). Sector regulations need also to ensure continuing access for poor and vulnerable people to basic public services of acceptable, equal or better quality than prior to the reforms. Respective stakeholder engagement is essential to avoid potential political risks, threatening the wider reform as well as development process.

Foreign participation in more sectors is expected to improve quality and drive down prices through increased competition, benefiting the final consumers. The net effect on overall job creation is ex ante ambiguous but is expected to be positive in the longer-run given the size of the market, income growth, urbanization, and the fact that the market has been historically underserved.

Depending on the sector, foreign participation may lead to increased inequality in access to certain goods/services. Continued engagement of the GoE as regulator and/or investor is essential to mitigate the risk of increasing inequality, resulting in barriers for vulnerable people to participate in the country’s development process as well as to political risks to the reform process.

Prior Action #7: The Board of the NBE has repealed the 27 Percent Rule.

The phasing out of the 27% rule is expected to increase credit to the private sector, which is currently very low as a share of GDP. Analysis based on the Enterprise Surveys shows that small firms, particularly in the service sector, have become more credit-constrained over time. The same analysis also shows that removing credit constraints is associated with employment growth in firms which had the constraint removed.

The unwinding of the 27% rule could temporarily affect the Development Bank of Ethiopia, and thus temporarily lower availability of funding to projects. Increased access to credit for private sector firms will help more efficient firms to grow, and this can lead to more sustainable growth through greater private sector employment.
### Prior Action #8: The Board of the NBE has approved financing through instruments at market-determined rates, and the first auction of treasury bills was conducted in December 2019.

The cost of financing for the Government will increase as new securities are issued at market rates and direct cash advances from NBE are phased out. This may reduce fiscal space and potentially reduce government spending, leading to a growth slowdown.

In the medium run, reduced public sector dependency on cash advances will help improving monetary policy discipline and bringing down inflation. In addition, both government and enterprises are expected to eventually gain access to additional sources of financing at longer maturities, which would help improving debt management and reducing macroeconomic risks.

### Prior Action #9: The Council of Ministers has approved for submission to Parliament a Federal Administrative Procedure Proclamation that provides for routine consultations on draft Directives, subject to specified exemption(s), and consultation is one of the pre-requisites for adoption of Directives.

Expected improvements in terms of transparency, accountability, and citizen engagement. No obvious poverty impacts.

In the medium run, reduced public sector dependency on cash advances will help improving monetary policy discipline and bringing down inflation. In addition, both government and enterprises are expected to eventually gain access to additional sources of financing at longer maturities, which would help improving debt management and reducing macroeconomic risks.

### Prior Action #10: (i) The Council of Ministers issues a regulation authorizing the creation of a holding entity for SOEs. (ii) The Council of Ministers has approved for submission to Parliament a draft Privatization of Public Enterprises Proclamation, which sets out a framework for the privatization of public enterprises.

In the short-term, privatization of SOEs is likely to result in job losses in the SOEs. Though data are scarce, there are indications that several SOEs are overstaffed. The majority of SOE employees have characteristics that make them highly employable on the labor market. Improved labor market intermediation or temporary income support may nevertheless be necessary given the high cost of job search in urban Ethiopia. For the minority of SOE employees who are older and uneducated, more permanent measures may be required (early retirement packages or inclusion in safety net programs). Respective stakeholder engagement is essential to avoid potential political risks, threatening the wider reform as well as development process.

Privatization of SOEs is expected to make them more efficient, improving quality of the services or products they provide. Effects on prices is ex ante unclear and depends on whether SOEs have been charging below-market rates or nor. Privatization of SOEs is also expected to improve public finances, expanding the fiscal space for social spending. There could be knowledge transfer from foreign investors that buy SOEs or participate in Joint Ventures.
**Prior action #1:** The PPP Directorate General has issued PPP Implementation Guidelines with the required procedures and authorizations to undertake PPP transactions, including an assessment of the contingent liabilities related to the sovereign contractual obligations.

3. **This prior action does not have any obvious poverty and social impacts in the short term.** In the longer-term, the action is expected to increase the government’s fiscal space, enhance efficiency in the sectors in which PPPs are introduced, and improve service delivery to citizens and investors. Given that PPPs may involve large-scale use of natural resources (e.g. hydropower) or apply to important social sectors (such as education and health), the Government has a critical role to play in ensuring appropriate standards and affordability of PPP contracts to avoid any adverse impacts. In this regard, the PPP Guidelines under this prior action include as requirements the need to assess contingent liabilities and conduct an Environmental and Social Impact assessment.

**Prior Action #2:** Under supervision of the EEA, the EEU and MoWIE have announced the implementation of a second electricity tariff increase under the multi-year electricity tariff increase framework in December 2019.

4. **Increases in the price of electricity have immediate negative effects on households’ purchasing power.** Under the new tariff trajectory, electricity pricing will be restructured from Increasing Block Tariffs (IBT) to Volume Differentiated Tariffs (VDT). Table A4-2 presents the pre-reform tariffs alongside the proposed final tariff structure, as it will stand after four iterations of tariff increases. The first iteration of tariff increases took place in 2018, and the final iteration will take place in 2021. Moving from an IBT towards a VDT structure means that heavily-using consumers will no longer be subsidized implicitly. Under the IBT structure, all consumers were benefiting from subsidies – for example a consumer in block 4 (201 to 300 kWh) would receive the cumulative subsidies of the first three blocks in addition to the block 4 subsidy. This pricing structure resulted in subsidies that were heavily skewed towards the better-off (see Figure A4-1). Under the VDT system, extremely low-income consumers (corresponding to those who are consuming in block 1) will not have any reduction in their subsidy level (the tariff will remain at ETB 0.273 per kWh). Heavy users, however, will see sharp reductions in subsidies. Users in block 4 will pay the assumed cost of production of ETB 2 per kWh, while those consuming in blocks 5, 6 and 7 will pay above the cost of production to cross-subsidize those in blocks 1, 2 and 3.\(^{52}\)

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\(^{52}\) Under the final tariff structure there will be no change to block 1 pricing, and so the subsidy level remains the same. 75 percent of the cost increase for the second block will be subsidized, and 25 percent of the cost increase for the third block will be subsidized. The fourth block will be charged at the cost of service. The fifth, sixth and seventh blocks will subsidize 10 percent, 15 percent, and 75 percent of the total required subsidy amount, respectively.
Table A4-2. Existing and proposed final electricity tariff structures for residential consumers

<table>
<thead>
<tr>
<th>Consumption range (kWh)</th>
<th>0-50</th>
<th>51-100</th>
<th>101-200</th>
<th>201-300</th>
<th>301-400</th>
<th>401-500</th>
<th>&gt; 500</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pre-reform tariff (ETB)</td>
<td>0.273</td>
<td>0.356</td>
<td>0.499</td>
<td>0.550</td>
<td>0.567</td>
<td>0.588</td>
<td>0.694</td>
</tr>
<tr>
<td>Proposed final tariff (ETB)</td>
<td>0.273</td>
<td>0.767</td>
<td>1.625</td>
<td>2.000</td>
<td>2.200</td>
<td>2.405</td>
<td>2.481</td>
</tr>
</tbody>
</table>

Source: Ethiopian Electric Power (EEP) and Ethiopian Electric Utility (EEU).

Note: Prices are in Ethiopian Birr, and the proposed final tariff structure represents the structure after the full four-year tariff reforms have been completed.

Figure A4-1: Per capita subsidy amounts and share of total subsidies by quintile under the original IBT pricing structure


5. The poor are expected to be affected less by the tariff increases given the low levels of electrification in Ethiopia. In 2016 around 11 per cent of poor households in Ethiopia had access to
electricity, though this is a lot higher for the urban poor (78 percent). Access is in general sparse and unevenly distributed. Just over half of the richest 20 per cent of households reported positive expenditure on electricity, while this number is under one fifth for households in the bottom 60 per cent. Overall the richest quintile spends approximately twice per capita on electricity than the poorest quintile.\textsuperscript{53} Expenditure levels are far higher in urban areas than they are in rural areas, and therefore the share of electricity in overall expenditure is much higher, on average, in urban areas. The proposed tariff reforms should create the fiscal space necessary to expand access and improve service. This is particularly necessary given that tariffs had been nominally constant over the decade before the reform. Another important priority should be to lessen the stark access to electricity gap that exists between rural and urban areas. Crowding in the private sector should help to meet the rapid growth in demand for electricity more efficiently but needs to be complemented by addressing these access and reliability challenges in the country.

6. \textbf{The tariff increases will lead to welfare losses across the distribution, though higher for wealthier households who consume more electricity.} To simulate the welfare effects of increased electricity prices, we combine the 2015/16 Household Consumption and Expenditure Survey (HCES) and the Social Accounting Matrix with the planned tariff increase schedule. The direct effects measure the immediate effect of a higher electricity bill on households’ real purchasing power, while the indirect effects measure the impacts on welfare through the price changes of products that are affected indirectly by a change in the price of electricity.\textsuperscript{54} The total effect is the sum of the direct and indirect effect.

7. \textbf{The total impact of the energy tariff reforms over the four years (direct and indirect effects together) in monetary terms is about six times higher for the richest quintile than for the poorest.} The effect is more muted when viewed as changes in the share of overall consumption. The total effect of the new tariff structure will reduce the spending power of the poorest quintile by a little over ETB 26 per person per month. In contrast, the reduction in consumption for the richest quintile is almost ETB 162 per month – about six times as large (Table A4-3). The reduction in welfare over the full four-year period for the top quintile is about 5.3%, while for the bottom quintile it is around 4.7% - still a significant effect given the already low levels of consumption of the poorest households\textsuperscript{55} (Table A4-3).

8. \textbf{The direct versus indirect impacts of the tariff reforms differ considerably across the consumption quintiles.} As the second and third panels of Table A4-3 show, the direct welfare impact is highest for the richest quintile, while the indirect impact for that group is the lowest. As a result, the share of the direct effect out of the total effect tends to increase over the distribution. For the poorest 3 quintiles (60 percent of the population) the direct share is around 55 percent. For the fourth quintile this rises to about two thirds, while for the richest the share is about 77 percent. This result is not surprising as access

\textsuperscript{53} Conditional on positive expenditure. As has been shown, access rates are very low for the poorest quintile.

\textsuperscript{54} Because input/output tables are used in the estimation of indirect effects, it is not possible to simulate the price increases block by block, as was done for direct effects. This is because the input/output table is aggregated by sector. The simulation of the indirect effects therefore uses the average price increase for industries over the four-year period of the reforms.

\textsuperscript{55} These estimates are likely to represent upper bounds as we assume a price-elasticity of zero (households do not decrease their electricity consumption because of the tariff increase). Households have decreased their electricity consumption, which means that the adverse monetary welfare effects are somewhat lower than those presented in Table A4-3.
to electricity is far higher in relatively richer households than in relatively poorer ones. The opposite holds true for the indirect impacts, as both rich and poor households are affected by changes in the price of goods that are produced with electricity as an intermediate input. When the indirect effects are disaggregated by sector most of the effect comes about because of rising food prices. The next biggest indirect effect comes from increases in the price of clothing, with smaller effects being attributable to communication and transport. The negative impact of food price increases is higher for poor households than for rich households, while the indirect effect of higher communication and transport prices is largest for the richest households.

Table A4-3. Total, direct and indirect impacts of the new tariff structure on monthly per capita well-being (after implementation of all four annual tariff reforms in 2018-2021)

<table>
<thead>
<tr>
<th></th>
<th>Total impact</th>
<th>Direct Impact</th>
<th>Indirect impact</th>
<th>Direct share</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>In ETB</td>
<td>In %</td>
<td>In ETB</td>
<td>In %</td>
</tr>
<tr>
<td>Poorest</td>
<td>-26.6</td>
<td>-4.7</td>
<td>-14.7</td>
<td>-2.6</td>
</tr>
<tr>
<td>2</td>
<td>-40.2</td>
<td>-4.3</td>
<td>-22.7</td>
<td>-2.4</td>
</tr>
<tr>
<td>3</td>
<td>-53.7</td>
<td>-4.4</td>
<td>-29.7</td>
<td>-2.4</td>
</tr>
<tr>
<td>4</td>
<td>-74.1</td>
<td>-4.8</td>
<td>-48.5</td>
<td>-3.1</td>
</tr>
<tr>
<td>Richest</td>
<td>-161.7</td>
<td>-5.3</td>
<td>-124.3</td>
<td>-4.1</td>
</tr>
</tbody>
</table>

Note: ETB are expressed in real 2019 terms, with price adjustments made from World Bank forecasts of national CPI.

9. The total effect of the change in the tariff structure is likely to have a disproportionately negative effect on female-headed households – a per capita reduction of well-being of about ETB 94, compared to a reduction of about ETB 65 for male-headed households. Female-headed households tend to be smaller than male-headed households and have higher overall consumption expenditure per capita. Female-headed households also have higher per capita expenditure on electricity, conditional on access, which means that they both benefit more from the current subsidies and will experience a relatively higher drop in consumption following the tariff reforms. Additional simulations that stratify by the sex of the household head show that not only do female-headed households tend to spend more on electricity per capita than male-headed households, they also have a higher share of total household expenditure that goes towards electricity. Therefore, the direct negative effect of the new tariff structure is larger for female-headed households. The magnitude of the indirect effect is broadly similar across male- and female-headed households.

10. General equilibrium analysis estimates are overall in line with results of a partial equilibrium analysis presented in the previous table. A general equilibrium analysis conducted to simulate the economy-wide effects of the tariff increases shows largely similar impacts on household welfare (real household consumption that is 4.7 percent lower by 2022 relative to a scenario without tariff increases). The negative impact is larger in cities and towns than in rural areas, where access to and spending on electricity is substantially lower. The negative effect on household welfare is projected to progressively taper off and decrease to 2.2 percent by 2030 (relative to the scenario of no tariff increases). It is worth noting that these results assume any additional revenue is used to reduce the fiscal deficit; if the
government was to employ it to fund infrastructure projects or boost social programs, the negative effect on household welfare would likely be milder.

11. **Given the negative effects on the purchasing power of the poor, the Government of Ethiopia would need to consider potential mitigation measures.** One potential mitigation measure is the scale-up of existing urban safety nets (urban because adverse effects will mainly be concentrated among the urban poor). The Urban Productive Safety Net Project (UPSNP – P151712) currently reaches about 590,000 low-income dwellers in 11 cities in Ethiopia, the majority of whom live in female-headed households. A new project that is currently being prepared (P169943) plans to scale up the safety net to over 40 cities, covering close to 1 million people. This scale-up would partly alleviate the adverse effects of tariff increases on the purchasing power of the poor.

12. **The frequent use of shared electricity meters merits attention.** Though the lifeline tariff remains unaffected by the reform, there is still a direct negative effect on the poor, which would usually consume less than 50kWh per month. This can potentially be explained by the use of shared meters. According to the 2015/16 HCES survey, 60 percent of the poor in Ethiopia use a shared meter. The use of a shared meter can mean that total electricity consumption of all households using the meter exceeds 50kWh, even though consumption of each of the households separately falls within the lifeline tariff. In such a scenario, which is likely to be quite common, poor households’ electricity bills would increase substantially despite the safeguarding of the lifeline tariff. Regularization of such shared meters, which is a core pillar of the GoE’s National Electrification Program and is being supported by the World Bank’s Ethiopia Electrification Program for Results (P160395), will partially mitigate these impacts. For those who are unable to pay the connection fee of ETB1,000 (which includes a private meter), the Bank is discussing with the electricity utility (EEU) the possibility of adjusting the connection policy to include subsidies or installment payments. The decision will depend on results of an affordability study that is planned.

**Prior Action #3:** *The Government’s Macroeconomic Committee has approved a phased restructuring of EEP’s debt in the power sector and the Ministry of Finance has implemented a conversion of loans on-lent to EEP into equity.*

13. **This prior action does not have obvious poverty and social impacts.** The conversion of loans on-lent by the MoF to the EEP into equity is not expected to have impact on the fiscal accounts, and, thus, would not be affecting the population. On the other hand, this action is expected to help the public utility reducing outstanding liabilities, moving towards cost recovery, and improving SOE’s perceived risks for potential lenders and investors.

**Prior Action #4:** *The Government’s Macroeconomic Committee has issued a decision that encourages competition by allowing private sector, including foreign firms, to access and offer value-added logistics services in dry ports.*

14. **Dry ports in Ethiopia have been reserved to the state-monopoly ESLSE (Ethiopia Shipping Line and Logistics Service Enterprise).** The private sector presently has limited possibilities to carry out value
adding activities. As a result, Modjo, the main dry port of the country, functions mainly as a single user terminal and Container Freight Station for the handling, loading and unloading of containers, despite having the potential to offer more services. It is expected that opening up the dry ports to private sector services providers will lead to a concept change for Modjo: from being an area of limited functionality (notably transshipment, stripping, stuffing and customs clearance) to an area where third parties will locate dedicated bonded and general warehousing, possibly in combination with light industry, so that the advantages of neighborhood productivity can be exploited. It is expected that this prior action will allow the dry port to evolve into a logistic hub that contains far more functions, while opening the possibility as well that private investors establish new dry ports.

15. **Opening the dry ports for private sector participation is expected to reduce the cost of logistics.** Inefficient and costly trade logistics are frequently mentioned as a binding constraint to business in enterprise surveys (World Bank, 2016). Estimates suggest that the cost of exporting would decline by 7 percent if the dry port is opened to other service providers and by an additional 8 percent if freight transport is shifted from road to rail. A computable general equilibrium (CGE) analysis indicates that reducing the cost of logistics would have positive effects on households through an employment and income channel. Relative to a baseline scenario of no logistics reforms, with the reforms overall employment would be 0.8 percent higher by 2030 (Figure A4-2). The positive employment effects are highest for agriculture, which accounts for the bulk of the exports and hence benefit most from improved logistics. Cash crop production could increase up to 12 percent relative to the baseline. The proposed reforms would also lead to higher household consumption levels, especially in rural areas, where the bulk of the population is involved in agriculture (Figure A4-3).

**Figure A4-2: Logistics reform is projected to increase employment...**

**Figure A4-3: ...and also boost household consumption**

16. **Given that the benefits of logistics reforms would be highest in rural areas and for households engaged in agriculture, it is highly likely to have poverty-reducing effects.** In addition, private sector

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56Presently, there is very little if any use of the Ethiopia – Djibouti railway line in export shipments.
participation in value-adding services in the dry ports is expected to create over 29,000 jobs. There may however also be short-term job losses in the government-owned logistics service provider if exposed to competition, as discussed in more detail at the end of this annex (under DPF2 Prior Action #10).

**Prior Action #5:** (i) The Prime Minister has appointed the Board for the ECA. (ii) The ECA has convened a public consultation on the selection process for new telecom operator licenses.

17. **Until recently, the telecom market in was a monopoly dominated by a state-owned service provider, Ethio Telecom.** Ethiopia currently ranks fifth-lowest in terms of mobile cellular penetration (37.2) and eight-lowest in terms of fixed broadband subscriptions (0.05) per 100 people in the SSA region, according to International Telecommunication Union (ITU). Household expenditures on mobile services is low at per year in 2016, especially for the poorest 10 percent of households, who spent a mere ETB 83 per year (US$10 per year in purchasing power parity terms) on mobile services in 2016 (only 14 percent of these households have positive spending on telecom services). Low spending on mobile services in the bottom deciles can be explained by several factors. First, network coverage remains incomplete, with an estimated 15 million of Ethiopians out of reach of the cellular network and 60 million without access to internet. Second, cost of handsets is high due to import taxes and the lack of a competitive retail market. Third, services on which low-income consumers tend to spend money on (such as mobile money) are not available in Ethiopia.

18. **Under the telecom sector reform, the Government of Ethiopia will award two new telecom operator licenses, hereby introducing competition in the telecom sector for the first time.** The new Communications Proclamation, passed by the House of People’s Representatives on June 13, 2019, creates the basis for a more liberalized market environment. The opening of the sector is expected to
result in price competition, with estimates suggesting a decline of prices by 25 percent in the short run and 67 percent in the long run. Already in 2001, Wallsten (2001) showed how competition in the telecommunications sector (measured by mobile operators not owned by the incumbent) in Africa and Latin America was correlated with decreases in the price of local calls, as well as with increases in the per capita number of mainlines, payphones, and connection capacity.58 More recently, Faccio and Zingales (2017) discuss how specific government procompetitive policies (such as allowing number portability to VoIP) can have significant effects in reducing concentration and prices, while having no negative impacts on service quality.59 The Ethiopian mobile market is expected to grow strongly after liberalization, especially on mobile data with a 47 percent annual growth, from a low base, between 2021 and 2024.60

19. Despite the expected strong growth following liberalization, the positive poverty impacts are estimated to be limited, mainly because of the current low spending by the poor on mobile services. Preliminary estimates using the WELCOM (Welfare and Competition) simulation tool developed by the World Bank suggest that moving to a more competitive market would induce a reduction in poverty by 0.2 percentage points in the short-run and 0.8 in the longer run.61 No significant negative distributional impacts are expected, as the estimated distributional effects of increasing the number of operators will benefit households with positive expenditure evenly, with an average relative incidence of 2 percent of expenditure across deciles (Figure A4-5). This simulation relies on data from the HCES (2015/16) household survey and assumed a decrease in Ethio Telecom’s market share from 100 percent to 45 percent for mobile services. The price elasticity of demand (PED) used to run the simulation was -1.5.62

Figure A4-5: Relative and absolute incidence by consumption decile
(HHs with positive expenditure, % of expenditure)

60 Data source: Research carried out by Roland Berger for the WBG.
61 The WELCOM (Welfare and Competition) simulation tool was developed by the Poverty and Equity GP at the World Bank. WELCOM estimates the distributional effects focusing on the price channel, simulating a change in prices in the good or market of interest as a result of changes in the competition conditions. Under the most basic approach, WELCOM simulates as the change in welfare for those households with positive consumption using a Laspeyres well-being money metric measure. For more information please refer to: Abdelkrim Araar, Eduardo Alonso Malasquez, Sergio Olivieri, Carlos Rodriguez Castelan, (2018), "Introducing WELCOM: A tool to simulate the welfare impacts of competition. Version 2.1", World Bank, August 2018. http://dasp.ecn.ulaval.ca/webwel/welcom.html
62 The price elasticity of demand (PED) utilized was -1.5 as there was no PED specific to Ethiopia’s mobile services market (Fuss, Melvyn (2005), “The Impact of Telecoms on Economic Growth in Developing Countries”. Vodafone Policy Paper Series 3). This preliminary estimate should be taken with reservation since the PED is from 2005 and corresponds to values obtained for a pool of developing countries. However, this solution is adequate due to scant empirical evidence on price elasticities of demand of mobile services in developing countries, particularly in Sub-Saharan Africa.
20. **The largest impact of the telecom reform may however be on the extensive margin.** A decline in prices, improved service quality and better network coverage should incentivize more people to use mobile services, connecting the previously unconnected to information, markets, and services. Using WELCOM’s results, a 25 percent drop in prices due to more competition in Ethiopia would see a 13.6 percent proportional increase in the take up of mobile services. Middle consumption deciles see the most potential uptake in users, with an average 15 percent increase in the likelihood of usage (Figure A4-6)\(^{63}\).

![Figure A4-6: More competition in the telecom sector is likely to induce use of mobile services](image)

*Percentage change in probability of mobile services take up due to welfare gains*

Source: HCES, 2015/16.

21. **New market entrants have important development implications as the rapid development of informational, educational, and financial services provided through mobile phones is transforming phones from simple tools of communication to fully-fledged service delivery platforms.** Improvements

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\(^{63}\) As with the results of any microsimulation exercise there are limitations to these estimates. First, WELCOM follows a partial equilibrium approach, thus only capturing the first-order effects of competition on welfare. Second, WELCOM only estimates the distributional effects of changes in market concentration through the price channel, potentially overlooking other impacts from alternative channels such as labor markets, the value of assets, product diversity and resource reallocation.
in mobile telecommunications network infrastructure and especially smartphone features, as measured by the deployment of cellular towers (service quality should be directly affected by the increased prevalence of cellular towers) and the availability of smartphone applications, respectively, increase consumer utility (Rennhoff, P. and Routon, W. 2016). If complementary reforms in other sectors are enacted (in particular, the financial sector), then mobile devices have the potential to help poor people to manage credit better, with lower transactions charges, and can improve their ability to cope with risks, leading to a reduction in vulnerability and poverty. Mobile money in particular offers great promise in reducing risks and smoothing consumption through formal and informal insurance and extending financial services to the large share of unbanked people in Ethiopia.

Prior Action #6: The Council of Ministers has approved for submission to Parliament a draft Investment Proclamation enabling foreign participation in a broader set of economic sectors (shift from positive to negative list of sectors).

22. The new Investment Proclamation is expected to boost competition, expand consumer choice and improve quality. The Investment Proclamation will open several sectors for the first time to foreign participation, either in the form of joint venture or full ownership. Prices of certain services are expected to decrease through increased competition, benefiting the final consumers. Certain sectors may see the emergence of quality-differentiated services, with higher prices being charged for better or more-efficient services. The analysis for this Poverty and Social Impact Assessment focuses on sectors that have moved from being exclusively reserved for domestic investors to becoming fully open to foreign investors. These include railways (results presented before under DPF2 Prior Action #4), health and education.

23. In the health sector, the approval of the Investment Proclamation will imply the opening of clinical and diagnostics services, so far reserved to domestic investors, to foreign investors. In Ethiopia, only seven and one percent of urban and rural health facilities, respectively, had the equipment needed to conduct eight different types of diagnostic. Foreign investment is expected to help respond to the limited availability of diagnostic services in the country. This includes a shortage of pathology and laboratory medicine, and imaging services, which are critical to the detection and treatment of disease. There will also be benefits to Ethiopians who own local diagnostic facilities, as foreign investors would usually want to invest in their businesses and keep them engaged as managers or part-owners of the facilities. Patients will benefit from more varied, accurate, and cheaper diagnostics tests. It will be important that adequate incentives and regulations are in place to ensure the realization of these potential benefits and a pro-poor and equitable impact. The Ministry of Health has requested advice from the World Bank on this regard.

24. Ethiopia has shown good progress in access to education but less so in actual student learning outcomes. The most recent survey data (2016) shows that one in three 15-to-24-year-olds had completed primary school (8 grades in Ethiopia), which is largely due to low completion rates in rural areas (one out of four). According to the Ministry of Education, whose numbers tend to be more optimistic, the primary

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school completion rate amounted to 58 percent in 2017/18, while gross enrolment in secondary school was 31 percent. The need to work to contribute to household income is the most commonly stated reason for early drop-out, both in primary and secondary (while in secondary, distance to schools is also an important constraint). In 2016, private schools accounted for approximately four percent of school enrolments in Ethiopia, rising however to 19 percent in urban Ethiopia. FDI in education can bring down costs and increase quality of private education in urban Ethiopia and bring private schooling, which is believed to be of higher quality, within the reach of larger numbers of urban households. The role of international and local NGOs would be important to support rural areas in which there are fewer financial incentives for for-profit private schools. To optimize the arrival of FDI, it will be important for the Ministry of Education to ensure easiness of establishment for foreign investors, while strengthening monitoring and accountability systems to ensure quality in service delivery as well as improving quality of public schools for households unable to afford access to private schools. Just like promoting a wider participation of for-profit private schools, regulations of NGOs (especially taxes and start-ups) may be reviewed and revised according to current needs in the market.

25. **The new Investment Proclamation may lead to job losses in the short-term, as incumbent firms lose market share to potentially more efficient entrants.** In the longer term the effects on net job creation are expected to be positive given the size of the market (and the current underserved nature of the market), urbanization and income growth. To minimize the short-term adverse effects of potential jobs losses, the government can consider actions that reduce the cost of job search in urban labor markets in Ethiopia, potentially through making information on vacancies more widely available at low cost and/or subsidizing job search. The urban safety net projects could also be leveraged to provide temporary income support to newly unemployed low-income workers who would find it difficult to secure a new job rapidly.

**Prior Action #7: The Board of the NBE has repealed the 27 Percent Rule.**

26. **Currently, private commercial banks are required to buy low-yielding five-year NBE Bills equivalent to 27 percent of all loans disbursed.** The removal of this 27 Percent Rule is expected to increase credit to the private sector, which is currently very low as a share of GDP (13 percent in 2018 compared to 45 percent in Sub-Saharan Africa). Lack of access to credit is consistently mentioned as a binding constraint to business in Ethiopia in all enterprise surveys and is identified as a binding constraint to growth and shared prosperity in the SCD (World Bank, 2016). Analysis of the World Bank’s Enterprise Surveys suggests that relaxing credit constraints, for small enterprises in particular, is associated with employment growth (Box 1). At the negative side, the repeal of the 27 Percent Rule can temporarily lower

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66 As on June 2019, NBE Bills mop up via the 27 percent rule was ETB 92 billion. Of those, NBE channeled about ETB 53 billion by way of NBE Bills to DBE. Of this, DBE has used about ETB 24 bn to lend, while the remaining ETB 29 bn has been re-invested in treasury bills. In sum, for every dollar in 27 percent proceeds received, the DBE was injecting just 26 cents as project loans to the private sector. The repeal of the 27 percent rule has thus resulted in the release of additional funding loanable to the private sector.
the availability of funding for projects through the Development Bank of Ethiopia (as proceeds from the scheme largely go to fund DBE).

**Prior Action #8:** The Board of the NBE has approved financing through instruments at market-determined rates, and the first auction of treasury bills was conducted in December 2019.

27. **This prior action will raise the cost of government borrowing as new securities are issued at market rates and direct cash advances from the central bank are phased out.** This is likely to decrease fiscal space and result in lower government spending, with effects on economic growth. In the medium-term however, the reduced dependence on direct cash advances is expected to bring down inflation which is currently in double digits and predominantly affects the poor. The reform is also expected to result in more varied and cheaper sources of financing becoming available to both government and private corporations in the long run.

**Box A4-1: Alleviating credit constraints is associated with job creation**

Many firms in Ethiopia are credit-constrained. According to the 2015 World Bank Enterprise Survey, about 40 percent of formal-sector firms in Ethiopia had a demand for credit that could not be met. Credit-constraints existed for all sectors of the economy but were particularly pervasive among smaller firms in the services sector: The share of small service sector firms that were credit-constrained increased from 40 percent in 2012 to 60 percent in 2015, while the share of manufacturing firms that were credit-constrained decreased from 30 percent to 19 percent in manufacturing. This reflects the overall policy direction of channeling most credit to State Owned Enterprises and the priority manufacturing sector.

Credit-constraints are holding back employment growth, particularly in the services sector. Econometric analysis on firm panel data shows that, conditional on demand, obtaining a loan is associated with a significant increase in employment in the service sector, suggesting that expanding access to credit may have significant employment effects. The estimated effects are economically significant and suggest an increase in employment by 12 to 32 percent for firms with fewer than 25 employees and 19 to 27 percent for firms with more than 25 employees. The estimated impacts are statistically significant only for smaller firms. These results suggest that more credit to the private sector, which is expected to result from the gradual elimination of the 27% rule, is likely to pay off in terms of job creation.

**Figure A4-7: The employment effects of removing credit constraints are substantial**

(Effect of removing credit constraints for firms with credit demand - point estimates and confidence bands)

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Prior Action #9: The Council of Ministers has approved for submission to Parliament a Federal Administrative Procedure Proclamation that provides for routine consultations on draft Directives, subject to specified exemption(s), and consultation is one of the pre-requisites for adoption of Directives.

28. This prior action will entail improvements in terms of transparency, accountability, and citizen engagement. There are no obvious poverty impacts.

Prior Action #10: (i) The Council of Ministers has issued Regulation No. 445/2019 authorizing the creation of a holding entity for SOEs. (ii) The Council of Ministers has approved for submission to Parliament a draft Privatization of Public Enterprises Proclamation, which sets out a framework for the privatization of public enterprises.

29. This prior action is expected to render former SOEs more efficient, improving quality of the services or products they provide. The effect on prices is ex ante unclear and depends on whether SOEs have been charging below-market rates or nor. Privatization of SOEs is also expected to improve public finances, expanding the fiscal space. There could also be knowledge transfer from foreign investors that buy SOEs or participate in Joint Ventures.

30. In the short-term though, privatization of SOEs is expected to lead to job losses. Though data are scarce, there are indications that some of the SOEs are overstaffed. Estimates by a consultancy firm indicates that Ethio Telecom, the state-owned telco operator, could shed 10,000 FTEs when privatized. Given the importance of SOEs in formal employment in Ethiopia, a closer look at potential poverty are social effects is warranted.
31. **Employees of SOEs are relatively well-off.** According to the 2018 Urban Employment and Unemployment Survey (UEUS), the average monthly wage of SOE employees amounted to ETB4,262 per month, compared to ETB3,519 for civil servants and ETB1,902 for private sector employees. In 2018, the median wage in the private sector (ETB1,200) was lower than the wage at the 10th percentile in public enterprises (ETB1,300). The difference in wages between SOEs and the private sector is largely explained by differences in worker characteristics. SOE employees are older, more educated, and more male than private sector employees, and these characteristics are associated with higher earnings. Public enterprises also tend to be active in sectors with higher wages, most notably finance. There is however also a minority of uneducated SOE employees, who tend to earn low wages.

**Figure A4-8: SOE employees have the highest average wages**

*Distribution of monthly wages, 2018 ETB*

![Graph showing distribution of monthly wages](image)

Source: 2018 UEUS

32. **Data from a different source (the 2015/16 poverty survey) also show that households with SOE employment are better off.** Public enterprise and public servant households both report significantly higher consumption per adult equivalent than the other category, as shown in Table A4-4. SOE households also have higher rates of access to electricity, improved water, and improved sanitation as compared to other households. Surprisingly though, poverty rates among SOE households are still substantial at 18 percent (compared to a national average of 24 percent)\(^68\).

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\(^68\) While SOE households are on average better-off in terms of consumption, the distribution plot shows a significant bunching at the low end of the welfare distribution. This means that there is a significant minority of SOE households that are relatively poor.
Table A4-4. Welfare by the employment type of household heads

<table>
<thead>
<tr>
<th></th>
<th>Public enterprise</th>
<th>Public servant</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consumption</td>
<td>17,996</td>
<td>20,128</td>
<td>11,810</td>
</tr>
<tr>
<td>Poverty rate</td>
<td>17.9%</td>
<td>9.7%</td>
<td>24.5%</td>
</tr>
<tr>
<td>Electricity</td>
<td>70.6%</td>
<td>72.8%</td>
<td>19.6%</td>
</tr>
<tr>
<td>Improved water</td>
<td>79.7%</td>
<td>76.7%</td>
<td>35.3%</td>
</tr>
<tr>
<td>Improved sanitation</td>
<td>18.1%</td>
<td>13.2%</td>
<td>3.3%</td>
</tr>
<tr>
<td>Household size</td>
<td>5.5</td>
<td>5.3</td>
<td>5.8</td>
</tr>
<tr>
<td>Dependency ratio</td>
<td>0.8</td>
<td>0.7</td>
<td>1.3</td>
</tr>
</tbody>
</table>

Source: HCES and WMS 2015/16

33. **The potential impacts of SOE retrenchment on living standards of laid-off employees is a key concern.** This impact will depend largely on three factors: The employability of laid-off employees (their competitiveness in the labor market), the other income sources of the employee and his or her household members, and the adequacy of social measures included in the SOE’s social plan. The survey data can give us some limited information on the first two factors.

34. **The majority of SOE employees seems highly employable.** 75 percent of SOE employees have a university degree, all have work experience (as they are currently employed in the SOE), and their age range corresponds to the prime labor market age in urban Ethiopia. In 2018, the unemployment rate for university-educated people between 25 and 50-years-old with prior work experience amounted to a mere 2.8 percent, compared to the overall urban unemployment rate of close to 20 percent. Lower-educated employees of SOEs who may be laid-off would likely find it harder to transition to new employment, though the fact that they have prior work experience would greatly improve their likelihood of finding new wage employment. Nevertheless, up-skilling or other active labor market policies could be considered for the lower-educated workers, while inclusion in the urban safety nets could be an option for the uneducated workers of SOEs (2.7 percent of SOE employees has no education at all – an estimated 41,000 people).

35. **Slightly over half (53 percent) of households of SOE employees have other employed people apart from the SOE employee.** 40 percent of households of SOE employees (“SOE households”) have other wage-employed members, and 25 percent of SOE households have other members employed in the public sector. These simple statistics suggest that households of SOE employees are relatively well-off. Indeed, total income from wage employment averages ETB 5,952 per month for households with a member that is employed in an SOE, compared to ETB1,194 for households without SOE employment (these numbers do not include income from self-employment, which is not measured in the survey). Similarly, SOE households have on average 1.3 people who finished university education, compared to 0.3 people in other households.

36. **In 47 percent of cases, the SOE employee is the only employed member in the household.** In these cases, losing the only labor income source can have disastrous consequences. 74 percent of SOE employees who are the only employed member in their households have a university degree, which, in
addition to their work experience, is expected to make them competitive in the Ethiopian labor market. Temporary income support may nevertheless be required to cater to the lengthy job search process in Ethiopia. For those with less education, especially for the 10 percent of SOE employees who did not go beyond primary school and are the only income-earner in their households, longer-term support may be needed. These low-skilled people tend to be older (average of 40-years-old) and will not be as competitive in the labor market. For those who are deemed hardly employable, inclusion in the expanded Urban Productive Safety Net Project may be necessary. For others, active labor market programs or tailored skilling interventions (e.g. drivers/operators of different categories of vehicles and machinery) may be more appropriate.

37. **To conclude, households in which a member is employed at a State-Owned Enterprise (SOE) are significantly better-off than the average household.** These households tend to have higher wage incomes, more wage-employed household members, higher education levels, and lower-than-average poverty rates. Most of the SOE employees are tertiary-educated, in prime labor-market age, and all have work experience, making them highly employable in urban labor markets. There is however a significant minority of SOE employees who are on average older, largely unskilled, and more likely to be poor. This segment is unlikely to be competitive in the labor market and would require special support in case of layoffs. In addition to the severance pay and early retirement packages determined by the Privatization Trustee Board, authorities could arrange intermediation sessions through their 1000 existing One Stop Shops on jobs and through private sector led employment services (such as those provided by EthioJobs, etc.) to facilitate the transition, among other mitigation measures. One of the components of the new Urban Safety Nets and Jobs Project focuses on the strengthening of employment and intermediation services. Depending on the specific personal and household background, other measures may include inclusion in existing productive safety nets, re- or upskilling programs to make workers more employable (in function of prevailing labor demand), in combination with tailored support to facilitate entry into self-employment.

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69 Formal sector workers in Ethiopia are eligible for severance ranging from 4.3 weeks of salary workers with 1-year tenure to 17.1 weeks for workers with a tenure of more than 10 years.
ANNEX 5: DEBT SUSTAINABILITY ANALYSIS

1. For the first time in several years, the debt stock as a share of GDP declined, although the economy remains at high risk of debt distress. Following its surge in FY15, the stock of publicly guaranteed external debt by SOEs remained around 10 percent of GDP in recent years, until it was reduced for the first time in FY19 (Figure A5-1). SOE domestic debt was also contained last year. Overall public sector debt declined from 59.5 percent of GDP in 2018 to 56.8 percent of GDP in FY19, driven by authorities’ efforts to curtail SOE external borrowing and the implementation of the agreed zero non-concessional borrowing policy. The 2019 DSA, prepared as part of the 2019 Article IV consultation and based on the new DSA framework for low-income countries (LIC-DSF), concluded that Ethiopia continues to be at “high” risk of external debt distress. Dismal export performance has kept the debt-to-exports and debt-service-to-exports indicators above their respective thresholds in the baseline scenario of the DSA, as detailed below.

Figure A5-1. Evolution of the public debt stock in Ethiopia

![Graph showing the evolution of public and publicly guaranteed external debt in Ethiopia.](image)

Source: World Development Indicators.
Note: Ethiopian Airlines is excluded from the SOE debt stock.

2. Debt reprofiling and continued concessional borrowing will be key for Ethiopia to achieve a moderate risk of debt distress. Authorities successfully renegotiated with bilateral donors the restructuring of non-concessional debt amounting to about US$4.5 billion (15 percent of total external debt). There was a narrowing of the interest rate margin for one of the loans, but no reductions in outstanding amount of debt were reported; as such, the restructured loans remain non-concessional. While the debt restructuring does not change the risk rating of Ethiopia, it has helped significantly alleviating debt service needs in the near term (Figure A5-2). Under the IMF program, Ethiopia aiming to achieve a “moderate” risk of external debt distress by 2022, on the back of further reprofiling of non-concessional loans and improving exports. Reprofiling of deposits agreed with Gulf countries in December
2019 is expected to further reduce debt payments by about 0.5 percentage points of GDP a year during FY21-23. In addition, continued concessional borrowing and appropriate burden sharing by multilateral and bilateral donors would be necessary. The World Bank has provided highly concessional support to Ethiopia in recent years, with the financing terms of IDA18 commitments being fifty percent grant and fifty percent IDA credit.

**Figure A5-2. External debt service needs of selected SOEs (% of Ethiopia’s exports)**

Source: Ethiopian authorities and WB-IMF staff estimates and projections.

3. **Under the baseline scenario, debt-to-GDP and debt-to-exports indicators are expected to decline.** The present value (PV) of debt-to-GDP (PVDY) is expected to peak in 2022 and remains well below its threshold throughout the projection period (Figure A5-3). The breach in the second debt stock indicator—the PV of debt-to-exports (PVDE)—is forecasted to be eliminated by 2024.

4. **The projected changes in the two debt service indicators reflect the maturity profile of Ethiopia’s non-concessional borrowing.** The debt service-to-exports indicator continues to breach significantly its threshold in 2020, prior to declining to below the threshold in 2022. The indicator then momentarily breaches the threshold again in FY25; this single-year breach reflects the maturing of the Eurobond issued in December 2014. This is also reflected in the debt service-to-revenue ratio, which would only breach the threshold under a most extreme shock scenario in 2025.

5. **The standard stress tests point to vulnerabilities to exports shocks.** The PVDY remains below the baseline under all stress test scenarios throughout the projection period. For both the PVDE and DSE ratios, the most significant shock is that to exports: a one-standard deviation shock to export growth leads to larger and more persistent breaches. The debt service-to-revenue indicator is most significantly affected by a one-time 30 percent nominal depreciation of the currency. Under this scenario, the indicator exceeds the 18-percent threshold in FY20-21.
6. **A shock to the terms of market financing worsens indicators related to debt service.** Ethiopia’s only marketable debt is the Eurobond, which matures in 2024. Under the baseline, both the near-term gross financing need and market perception of risk (the spread between the yield of the debt and the EMBI) remain below the thresholds that signal heightened risk. A shock to the financing terms would substantially worsen the debt service indicators, particularly the debt service-to-export ratio.

**Figure A5-3. Indicators of External PPG Debt Sustainability Analysis, 2019**

Source: Ethiopian authorities and WB-IMF staff estimates and projections.

7. **Overall public debt does not flag additional risks to those stemming from the external debt** (Figure A5-4). The present value of total public debt stays well below the threshold of 55 percent of GDP in the baseline and under all scenarios considered throughout the projection period. This baseline already assumes a gradual increase in domestic interest rates and a reduction in NBE direct and indirect financing to the Government and the SOEs.
Figure A5-4. Ethiopia, indicators of Public Debt Under Alternative Scenarios, 2020-30

PV of Debt-to-GDP Ratio

PV of Debt-to-Revenue Ratio

Debt Service-to-Revenue Ratio

Source: Ethiopian authorities and WB-IMF staff estimates and projections.
### ANNEX 6: ENVIRONMENT AND POVERTY/SOCIAL ANALYSIS TABLE

<table>
<thead>
<tr>
<th>Prior Actions</th>
<th>Significant environmental effects (positive or negative)</th>
<th>Significant poverty, social, or distributional effects (positive or negative)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Pillar 1: Maximizing finance for development</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Prior Action #1:</strong> The PPP Directorate General has issued PPP Implementation Guidelines with the required procedures and authorizations to undertake PPP transactions, including an assessment of the contingent liabilities related to the sovereign contractual obligations.</td>
<td>Yes - negative</td>
<td>Yes – both positive and negative</td>
</tr>
<tr>
<td><strong>Prior Action #2:</strong> Under supervision of the EEA, the EEU and MoWIE have announced the implementation of a second electricity tariff increase under the multi-year electricity tariff increase framework in December 2019.</td>
<td>Yes - positive</td>
<td>Yes - negative</td>
</tr>
<tr>
<td><strong>Prior Action #3:</strong> The Government’s Macroeconomic Committee has approved a phased restructuring of EEP’s debt in the power sector and the Ministry of Finance has implemented a conversion of loans on-lent to EEP into equity.</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td><strong>Prior Action #4:</strong> The Government’s Macroeconomic Committee has issued a decision that encourages competition by allowing private sector, including foreign firms, to access and offer value-added logistics services in dry ports.</td>
<td>No</td>
<td>Yes – positive</td>
</tr>
<tr>
<td><strong>Prior Action #5:</strong> (i) The Prime Minister has appointed the Board for the ECA. (ii) The ECA has convened a public consultation on the selection process for new telecom operator licenses.</td>
<td>No</td>
<td>Yes – positive</td>
</tr>
<tr>
<td><strong>Pillar 2: Improving the investment climate and developing the financial sector</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Prior Action #6:</strong> The Council of Ministers has approved for submission to Parliament a draft Investment Proclamation enabling foreign participation in a broader set of economic sectors (shift from positive to negative list of sectors).</td>
<td>No</td>
<td>Yes – both positive and negative</td>
</tr>
<tr>
<td><strong>Prior Action #7:</strong> The Board of the NBE has repealed the 27 Percent Rule.</td>
<td>No</td>
<td>Yes – positive</td>
</tr>
<tr>
<td><strong>Prior Action #8:</strong> The Board of the NBE has approved financing through instruments at market-determined rates, and the first auction of treasury bills was conducted in December 2019.</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td><strong>Pillar 3: Enhancing transparency and accountability</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Prior Action #9:</strong> The Council of Ministers has approved for submission to Parliament a Federal Administrative Procedure Proclamation that provides for routine consultations on draft Directives, subject to specified exemption(s), and consultation is one of the pre-requisites for adoption of Directives.</td>
<td>No</td>
<td>Yes - positive</td>
</tr>
<tr>
<td><strong>Prior Action #10:</strong> (i) The Council of Ministers has issued Regulation No. 445/2019 authorizing the creation of a holding entity for SOEs. (ii) The Council of Ministers has approved for submission to Parliament a draft Privatization of Public Enterprises Proclamation, which sets out a framework for the privatization of public enterprises.</td>
<td>No</td>
<td>Yes – both positive and negative</td>
</tr>
</tbody>
</table>