



# Program Information Document (PID)

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Appraisal Stage | Date Prepared/Updated: 27-Sep-2018 | Report No: PIDA25537



**BASIC INFORMATION**

**A. Basic Project Data**

Country	Project ID	Project Name	Parent Project ID (if any)
Ethiopia	P168566	Ethiopia Growth and Competitiveness (P168566)	
Region	Estimated Board Date	Practice Area (Lead)	Financing Instrument
AFRICA	30-Oct-2018	Macroeconomics, Trade and Investment	Development Policy Financing
Borrower(s)	Implementing Agency		
Federal Democratic Republic of Ethiopia - Ministry of Finance and Economic Cooperation	Federal Democratic Republic of Ethiopia - Ministry of Finance and Economic Cooperation		

**Proposed Development Objective(s)**

The proposed operation is structured around three strategic pillars: (i) maximizing finance for development; (ii) boosting competitiveness through a better environment for the private sector; and (iii) enhancing public transparency and accountability to promote good governance.

**Financing (in US\$, Millions)**

**SUMMARY**

<b>Total Financing</b>	1,200.00
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**DETAILS**

<b>Total World Bank Group Financing</b>	1,200.00
World Bank Lending	1,200.00

**Decision**

The review did authorize the team to appraise and negotiate



## B. Introduction and Context

### Country Context

**Ethiopia, a growing economy with a population of over 100 million located in the conflict-affected Horn of Africa region, is experiencing an unprecedented political and economic change.** A new Prime Minister came to power in April 2018, during one of Ethiopia's worst political and social crises in decades, which had forced the government to declare a state of emergency twice in three years. Since his appointment, the Prime Minister has taken bold steps to restore peace with Eritrea following two decades of conflict, and his 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 announced 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, this shift has a potential to transform economic and political landscape in Horn of Africa and the entire continent.

**Over the past decade, Ethiopia has achieved substantial progress in promoting economic, social, and human development.** For the last 10 years, the Ethiopian economy has grown at an annual rate of over 10 percent in real terms, making Ethiopia one of the world's fastest-growing economies. This period of robust growth was driven by large-scale public investment in infrastructure and energy, which was made possible by favorable commodity prices and international debt-relief efforts in the mid-2000s. The poverty rate declined from 55.5 percent in 2000 to 26.7 percent in 2016,<sup>1</sup> and Ethiopia made significant progress on the Millennium Development Goals (MDGs). Primary enrollment rate quadrupled, child mortality rate halved, and the number of people with access to clean water more than doubled. Average life expectancy has increased by about one year annually since 2000 and is now higher than the averages for both Sub-Saharan Africa (SSA) and low-income countries worldwide.

**Ethiopia's growth has been driven by public investment and agricultural growth.** The Government has sustained high levels of public investment which has driven strong growth in agriculture and services. This has been financed by tapping external financing, keeping government consumption low and deploying heterodox mechanisms including financial repression that kept interest rates low and directed credit to public infrastructure, an overvalued exchange rate that cheapened public capital imports, and direct central bank financing of the budget. Despite substantial investments in infrastructure to support future growth, Ethiopia's recent economic success has occurred in a context of modest structural economic transformation and private-sector development. Growing macroeconomic vulnerability and reducing fiscal space threaten the long-term sustainability of Ethiopia's growth model.<sup>2</sup> There has been relatively slow progress in the development of a vibrant private sector especially in manufacturing and modern services, growing indebtedness including in major state owned enterprises (SOEs) and persistent inflation. As the GTP II nears its midpoint, the government is shifting its focus to expand private-sector participation in an effort to enhance economic dynamism.

<sup>1</sup> The poverty rate is measured at the international poverty line of US\$1.9 per day in 2011 purchasing-power-parity terms.

<sup>2</sup> World Bank. 2016. *Ethiopia's Great Run: The Growth Acceleration and How to Pace It*. Washington, DC: World Bank Group



## Relationship to CPF

**The DPO is consistent with the WBG CPS 2018-2022** for Ethiopia which supports the Ethiopian government GTP II and aligns with the WBG twin goals of eliminating extreme poverty and boosting shared prosperity and achievement of the Sustainable Development Goals (SDGs). The CPS is organized around three focus areas: (i) Promote Structural and Economic Transformation through Increased Productivity (ii) Building Resilience and Inclusiveness and (iii) Supporting Institutional Accountability and Confronting Corruption. This DPO will help achieve some specific goals set in the CPS including enhanced business and investment climate, improved access to finance for MSMEs, adoption of new approaches for sustainable infrastructure financing and debt management, and strengthened citizen engagement and holding government entities accountable. The DPO's actions aiming to create more fiscal space also support the objectives of building resilience and inclusiveness by making more domestic public financial resources available to finance social programs and develop buffers for shocks, including natural disasters. In addition, the proposed DPO focuses on increasing the role of the private sector and integrating transparency and accountability reinforcing sectoral engagements envisaged in the CPS.

### C. Proposed Development Objective(s)

The proposed operation is based on three program development objectives: (i) mobilizing private investment through PPPs; (ii) improving competitiveness to foster private sector growth; and (iii) enhancing public transparency and accountability to promote good governance.

#### Key Results

The key results of the operation includes: (i) mobilizing private investments through Public Private Partnerships (PPP); (ii) reforming the power sector to prepare for more private participation and competition; (iii) reform the logistics sector to reduce costs and improve efficiency through private sector participation and competition; (iv) reform the telecom sector to improve connectivity to prepare for more private participation and competition; (v) improve the investment climate to foster private sector growth; (vi) take steps towards modernizing the financial sector to meet the needs of a growing private sector; (vii) ensure the proper functioning of the government bond market and foreign exchange market; (viii) promote citizen information and participation; and (viii) improve public enterprise management, transparency and accountability.

### D. Project Description

The proposed development policy operation (DPO) is the first in a programmatic series of three DPOs. The proposed DPO will be the first World Bank budget support operation to Ethiopia in over a decade. It will support the implementation of the government's Second Growth and Transformation Plan (GTP II) and advance Ethiopia's strategic vision for becoming a lower-middle-income country by 2025. The DPO will support the government's reform program, with a focus on maximizing finance for development, boosting competitiveness by encouraging competition in the economy, and improving public-sector transparency and accountability.

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. Recent policies directing the bulk of domestic bank credit to publicly provided infrastructure and basic services greatly increased the public capital stock, but



also led to the rapid accumulation of public external debt. To sustain high growth rates, Ethiopia needs to identify sustainable ways to finance infrastructure. This can be achieved by (i) mobilizing private investments through PPP; (ii) reforming the power sector to prepare for more private participation and competition; (iii) reforming the logistics sector to reduce costs and improve efficiency; and (iv) reforming the telecom sector to improve connectivity and prepare for more private sector participation and competition.

To advance the pace of structural and economic transformation, the role of the private sector in the Ethiopian economy needs to be strengthened by addressing challenges around the investment climate, financial sector, and the government bond and foreign exchange markets. Thus, the Government needs to ensure that the conditions are in place for a more vibrant private sector. This would require coordinated efforts to (i) improve the investment climate to foster private sector growth; (ii) take steps towards modernizing financial sector to support the needs of a growing economy; and (iii) modernize the government bond and foreign exchange markets.

Transparency and accountability in the conduct of public affairs and access to information by the civil society, citizens and the media create a feedback loop that is important in strengthening service delivery, helping the Government and public enterprises direct resources where the needs and priorities are, and empowering citizens in matters affecting their lives. The third pillar of this operation would therefore aim at: (i) promoting citizen information and participation; and (ii) improving public enterprises management, transparency and accountability.

## E. Implementation

### Institutional and Implementation Arrangements

**MOFEC will be 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 DPO series fall under the purview of five ministries (MCIT, MOFEC, MOPE, MOT and MOWIE) and several federal government agencies, a Project Coordinating Committee was established for overseeing the preparation of the operation. This Committee will remain in place during the implementation of the Program and until completion of the DPO series. MOFEC is responsible for coordinating the work of this Committee and will coordinate with other ministries and agencies the monitoring of the results indicators and evaluation activities.

**Data availability and quality are appropriate to monitor progress of the DPO Program.** The Program outcomes will be monitored through results indicators as detailed in the Policy and Results Matrix. 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 the MOFEC on a timely manner. MOFEC will be responsible for submitting such information at a frequency and in a format satisfactory to the Bank. The World Bank will provide implementation support, including technical assistance in needed reform areas as described above, to ensure timely implementation and adequate data collection and monitoring of indicators and outcomes of the program.

## F. Poverty and Social Impacts and Environmental Aspects

### Poverty and Social Impacts



**Overall, the proposed DPO supports policy and institutional changes that are likely to have poverty-reducing effects in the medium term, though there will also be distributional impacts that should be addressed.** Although the operation is expected to have an overall positive impact on poverty reduction in the medium term, there may be some adverse effects in the short term. This is particularly true of the policy reform of electricity subsidies, which is expected to have the largest direct impact of all the proposed changes. The implications of the other structural reforms are likely to have some potentially positive significant poverty and distributional implications. Improvements in the business and private sector environment through PPP and SOE reform, and through addressing some of the key constraints to business operations are expected to lead to a higher level of foreign investment, and the establishment of new enterprises in the country. This should help to create additional jobs which will go some way to helping to absorb the approximately 2 million young Ethiopians who enter the labor force each year.

#### Environmental Aspects

**The reforms supported by this operation are expected to accelerate private sector investment, with potentially significant effects on the environment and natural resources.** The policy actions most likely to cause downstream environmental and social effects include those promoting Public Private Partnerships, streamlining business regulations, and facilitating investment. These actions need to be viewed in the context of Ethiopia's weak institutional capacity to manage and control potentially negative effects of investment projects, in particular the weak system for conducting ESIA's and enforcing compliance with the results. The program supports the establishment of independent authority to review, approve and enforce ESIA's

#### G. Risks and Mitigation

**The overall risk rating of this operation is substantial.** The major risks to achieve the development objectives of this operation include: a) political and governance risk; b) macroeconomic risks related to high level of external indebtedness and weak revenue performance; c) sector strategies and stakeholder risks; d) weak institutional and implementation capacity; and e) fiduciary, environmental and social. The implementation of actions supported under this operation will help address some of the risks and vulnerabilities in medium term. Technical assistance provided by World Bank and other development partners will provide important support to address risks as part of the government reform implementation.

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#### CONTACT POINT

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**APPROVAL**

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**Approved By**

Country Director:	Carolyn Turk	01-Oct-2018
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