

**Document of
The World Bank**

Report No.: 43336

PROJECT PERFORMANCE ASSESSMENT REPORT

ETHIOPIA

**ECONOMIC REHABILITATION SUPPORT CREDIT
(CREDIT 3512)**

**ECONOMIC STRUCTURAL ADJUSTMENT CREDIT
(CREDIT 3666)**

**FIRST POVERTY REDUCTION SUPPORT OPERATION
(LOAN/CREDIT H0730)**

**SECOND POVERTY REDUCTION SUPPORT OPERATION
(LOAN: JPN 51119, IDA H1350, JPN 5380)**

April 21, 2008

*Country Evaluation and Regional Relations
Independent Evaluation Group (World Bank)*

Currency Equivalents (annual averages)

Currency Unit = Ethiopian Birr (ETB)

US\$1.00 = ETB 8.51
ETB 1.00 = US\$0.10

Fiscal Year

Government: July 8 – July 7

Abbreviations and Acronyms

AAA	Analytical and Advisory Activities	ISS	Interim Support Strategy
ADLI	Agricultural Development Led Industrialization	JBAR	Joint Budget and Aid Review
AIDS	Acquired Immune Deficiency Syndrome	M&E	Monitoring and Evaluation
CAE	Country Assistance Evaluation	MDG	Millennium Development Goal
CAS	Country Assistance Strategy	MEFF	Macroeconomic and Fiscal Framework
CFAA	Country Financial Accountability Assessment	MOED	Ministry of Education
CPAR	Country Procurement Assessment Report	MOFED	Ministry of Finance and Economic Development
ERSC	Ethiopia Economic Rehabilitation Support Credit	OED	Operations Evaluation Department
ESAC	Economic Structural Adjustment Credit	PBS	Protection of Basic Services
ESW	Economic and Sector Work	PEP	Public Expenditure Program
ET	Ethiopia	PER	Public Expenditure Review
FY	Fiscal Year	PPAR	Project Performance Assessment Report
GDP	Gross Domestic Product	PRGF	Poverty Reduction and Growth Facility
GOE	Government of Ethiopia	PRSC	Poverty Reduction Support Credit
HIV	Human Immunodeficiency Virus	PSCAP	Public Sector Capacity Building Program
HSDP	Health Sector Development Program	PSD	Private Sector Development
ICR	Implementation Completion Report	PSIA	Poverty and Social Impact Assessment
IDA	International Development Association	PSDIP	Public Sector Delivery Improvement Policy
IEG	Independent Evaluation Group	QAG	Quality Assurance Group
IEGWB	Independent Evaluation Group (World Bank)	ROPE	Result-Oriented Performance Evaluation
IFC	International Finance Corporation	SDPRP	Sustainable Development and Poverty Reduction Program
IMF	International Monetary Fund	SWAp	Sector-wide Approach
I-PRSP	Interim Poverty Reduction Strategy Paper		

Director-General, Independent Evaluation	:	Mr. Vinod Thomas
Director, Independent Evaluation Group (World Bank)	:	Ms. Cheryl W. Gray
Senior Manager, IEGCR	:	Mr. Ali M. Khadr
Task Manager	:	Mr. James Sackey
Primary Author	:	Mr. Gene Tidrick

IEGWB Mission: Enhancing development effectiveness through excellence and independence in evaluation.

About this Report

The Independent Evaluation Group assesses the programs and activities of the World Bank for two purposes: first, to ensure the integrity of the Bank's self-evaluation process and to verify that the Bank's work is producing the expected results, and second, to help develop improved directions, policies, and procedures through the dissemination of lessons drawn from experience. As part of this work, IEGWB annually assesses about 25 percent of the Bank's lending operations through field work. In selecting operations for assessment, preference is given to those that are innovative, large, or complex; those that are relevant to upcoming studies or country evaluations; those for which Executive Directors or Bank management have requested assessments; and those that are likely to generate important lessons.

To prepare a Project Performance Assessment Report (PPAR), IEGWB staff examine project files and other documents, interview operational staff, visit the borrowing country to discuss the operation with the government, and other in-country stakeholders, and interview Bank staff and other donor agency staff both at headquarters and in local offices as appropriate.

Each PPAR is subject to internal IEGWB peer review, Panel review, and management approval. Once cleared internally, the PPAR is commented on by the responsible Bank department. IEGWB incorporates the comments as relevant. The completed PPAR is then sent to the borrower for review; the borrowers' comments are attached to the document that is sent to the Bank's Board of Executive Directors. After an assessment report has been sent to the Board, it is disclosed to the public.

About the IEGWB Rating System

IEGWB's use of multiple evaluation methods offers both rigor and a necessary level of flexibility to adapt to lending instrument, project design, or sectoral approach. IEGWB evaluators all apply the same basic method to arrive at their project ratings. Following is the definition and rating scale used for each evaluation criterion (additional information is available on the IEGWB website: <http://worldbank.org/ieg>).

Outcome: The extent to which the operation's major relevant objectives were achieved, or are expected to be achieved, efficiently. The rating has three dimensions: relevance, efficacy, and efficiency. *Relevance* includes relevance of objectives and relevance of design. Relevance of objectives is the extent to which the project's objectives are consistent with the country's current development priorities and with current Bank country and sectoral assistance strategies and corporate goals (expressed in Poverty Reduction Strategy Papers, Country Assistance Strategies, Sector Strategy Papers, Operational Policies). Relevance of design is the extent to which the project's design is consistent with the stated objectives. *Efficacy* is the extent to which the project's objectives were achieved, or are expected to be achieved, taking into account their relative importance. *Efficiency* is the extent to which the project achieved, or is expected to achieve, a return higher than the opportunity cost of capital and benefits at least cost compared to alternatives. The efficiency dimension generally is not applied to adjustment operations. *Possible ratings for Outcome:* Highly Satisfactory, Satisfactory, Moderately Satisfactory, Moderately Unsatisfactory, Unsatisfactory, Highly Unsatisfactory.

Risk to Development Outcome: The risk, at the time of evaluation, that development outcomes (or expected outcomes) will not be maintained (or realized). *Possible ratings for Risk to Development Outcome:* High Significant, Moderate, Negligible to Low, Not Evaluable.

Bank Performance: The extent to which services provided by the Bank ensured quality at entry of the operation and supported effective implementation through appropriate supervision (including ensuring adequate transition arrangements for regular operation of supported activities after loan/credit closing, toward the achievement of development outcomes. The rating has two dimensions: quality at entry and quality of supervision. *Possible ratings for Bank Performance:* Highly Satisfactory, Satisfactory, Moderately Satisfactory, Moderately Unsatisfactory, Unsatisfactory, Highly Unsatisfactory.

Borrower Performance: The extent to which the borrower (including the government and implementing agency or agencies) ensured quality of preparation and implementation, and complied with covenants and agreements, toward the achievement of development outcomes. The rating has two dimensions: government performance and implementing agency(ies) performance. *Possible ratings for Borrower Performance:* Highly Satisfactory, Satisfactory, Moderately Satisfactory, Moderately Unsatisfactory, Unsatisfactory, Highly Unsatisfactory.

Contents

PRINCIPAL RATINGS	VII
KEY STAFF RESPONSIBLE	IX
PREFACE	XI
SUMMARY	XIII
1. BACKGROUND	1
Overview of Economic and Social Progress	2
2. ECONOMIC REHABILITATION SUPPORT CREDIT.....	9
Background.....	9
Objectives and Components	10
Relevance of Objectives and Design	10
Achievement of Objectives (Efficacy)	11
Outcome	12
Risks to Development Outcomes	13
Monitoring and Evaluation Design, Implementation, and Utilization	13
Bank Performance	14
Borrower Performance.....	14
3. ETHIOPIA STRUCTURAL ADJUSTMENT CREDIT	15
Background.....	15
Objectives.....	15
Relevance of Objectives and Design	16
Achievement of Objectives (Efficacy)	17
Outcome	18
Risks to Development Outcomes	19
Monitoring & Evaluation	19
Bank Performance	19
Borrower Performance.....	20
4. FIRST POVERTY REDUCTION SUPPORT OPERATION (PRSC I)	21
Background.....	21
Objectives and Components	21

	Relevance of Objectives and Design	23
	Achievement of Objectives (Efficacy)	24
	Outcome	27
	Risks to Development Outcomes	27
	Monitoring and Evaluation Design, Implementation, and Utilization	27
	Bank Performance	27
	Borrower Performance	28
5.	SECOND POVERTY REDUCTION SUPPORT OPERATION (PRSC II)	29
	Background	29
	Objectives and Components	29
	Relevance of Objectives and Design	31
	Achievement of Objectives (Efficacy)	31
	Outcome	34
	Risks to Development Outcomes	34
	Monitoring and Evaluation Design, Implementation, and Utilization	34
	Bank Performance	34
	Borrower Performance	35
6.	OVERALL PRSC PROGRAM	37
	What Worked and What Didn't	37
	Choice of Instrument	38
	Avoiding Pitfalls of Direct Budget Support	40
	Summary Findings and Rating	40
	Lessons	41

Tables

Table 1. Components of Operations	2
Table 2. Ethiopia: Selected Macroeconomic and Performance Indicators 1998/99 - 2005/06	4
Table 3. Trends in the Education Sector	7
Table 4. Achievements in the Health Sector	7

Figures

Figure 1. The Incidence of Poverty, 1989-2004	5
---	---

Annexes

ANNEX A: BASIC DATA SHEET	43
ANNEX B: ETHIOPIA ECONOMIC REHABILITATION SUPPORT CREDIT - POLICY REFORM MATRIX	49
ANNEX C: ETHIOPIA - ECONOMIC STRUCTURAL ADJUSTMENT CREDIT – POLICY MATRIX	55
ANNEX D: ETHIOPIA FIRST POVERTY REDUCTION SUPPORT CREDIT- POLICY MATRIX	61
ANNEX E: POVERTY REDUCTION SUPPORT CREDIT 2 DPL - FY05 POLICY MATRIX	69
ANNEX F: PRSCII RESULTS MATRIX	81
ANNEX G: THE INVESTMENT CLIMATE AND PRIVATE SECTOR DEVELOPMENT IN ETHIOPIA	83

Principal Ratings

	<i>ICR*</i>	<i>ICR Review*</i>	<i>PPAR</i>
<i>ECONOMIC REHABILITATION SUPPORT CREDIT-P072890</i>			
Outcome	Highly Satisfactory	Moderately Satisfactory	Moderately Satisfactory
Institutional Development Impact**	Modest	Modest	--
Risk to Development Outcome	--	--	Modest
Sustainability***	Unlikely	Likely	--
Bank Performance	Satisfactory	Satisfactory	Moderately Satisfactory
Borrower Performance	Satisfactory	Satisfactory	Satisfactory
<i>ECONOMIC STRUCTURAL ADJUSTMENT CREDIT- P074585</i>			
Outcome	Satisfactory	Moderately Satisfactory	Moderately Satisfactory
Institutional Development Impact**	Modest	Modest	--
Risk to Development Outcome	--	--	Modest
Sustainability***	Unlikely	Likely	--
Bank Performance	Satisfactory	Satisfactory	Moderately Satisfactory
Borrower Performance	Satisfactory	Satisfactory	Moderately Satisfactory
<i>FIRST POVERTY REDUCTION SUPPORT OPERATION - P074014</i>			
Outcome	Satisfactory	Moderately Satisfactory	Moderately Satisfactory
Risk to Development Outcome	Negligible to Low	Significant	Significant
Bank Performance	Satisfactory	Moderately Satisfactory	Satisfactory
Borrower Performance	Satisfactory	Moderately Satisfactory	Moderately Satisfactory
<i>PRSC 2 DPL (FY05) - P077749</i>			
Outcome	Satisfactory	Moderately Unsatisfactory	Moderately Unsatisfactory
Risk to Development Outcome	Negligible to Low	Significant	Significant
Bank Performance	Satisfactory	Moderately Satisfactory	Moderately Satisfactory
Borrower Performance	Satisfactory	Moderately Satisfactory	Moderately Satisfactory

* The Implementation Completion Report (ICR) is a self-evaluation by the responsible Bank department. The ICR Review is an intermediate IEGWB product that seeks to independently verify the findings of the ICR.

**As of July 1, 2006, Institutional Development Impact is assessed as part of the Outcome rating.

***As of July 1, 2006, Sustainability has been replaced by Risk to Development Outcome. As the scales are different, the ratings are not directly comparable.

Key Staff Responsible

Project	Task Manager/ Leader	Division Chief/ Sector Director	Country Director
<i>ECONOMIC REHABILITATION SUPPORT CREDIT P072890</i>			
Appraisal	Miria Pigato	Fred Kilby	Oey Astra Meesook
Completion	Dino Merotto	Robert R. Blake	Ishac Diwan
<i>ECONOMIC STRUCTURAL ADJUSTMENT CREDIT P074585</i>			
Appraisal	Miria Pigato	Fred Kilby	Ishac Diwan
Completion	Dino Merotto	Robert Blake	Ishac Diwan
<i>First Poverty Reduction Support Operation - P074014</i>			
Appraisal	Gaiv M. Tata	Demba Ba	Ishac Diwan
Completion	Trina S. Haque	Laura Frigenti	Ishac Diwan
<i>PRSC 2 DPL (FY05) - P077749</i>			
Appraisal	Trina S. Haque	Laura Frigenti	Ishac Diwan
Completion	Trina S. Haque	Laura Frigenti	Ishac Diwan

Preface

This is the Project Performance Assessment Report (PPAR) for the Ethiopia Economic Rehabilitation Support Credit (P072890; Credit: C3512); the Economic Structural Adjustment Credit (P074585; Loan/Credit C3666); First Poverty Reduction Support Credit (P074014; Loan/Credit H0730) and the Second Poverty Reduction Support Credit (P077749; Loan: JPN 51119, IDA H1350, JPN 5380). These four operations were undertaken within a period of less than four years. The first two credits were independent operations which were intended to prepare for a series of Poverty Reduction Support Credits (PRSCs), and the last two operations were part of a projected series of three PRSC operations.

The Economic Rehabilitation Support Credit (ERSC) of \$150 million was approved by the Bank's Board on June 5, 2001. It was associated with an IMF three-year ESAF arrangement approved in December 2000 for \$111 million. The Economic Structural Adjustment Credit (ESAC) of \$120 million was approved by the Bank's Board on June 18, 2002. Like the ERSC, the ESAC had both stabilization and reform objectives.

The First Poverty Reduction Support Credit (PRSC I) of \$120 million was approved on February 17, 2004 to support the 2003/04 budget for Ethiopia. The Second Poverty Reduction Credit (PRSC II) of \$130 million was approved on November 30, 2004 to support the 2004/05 budget. The PRSC program was suspended after PRSC II because of governance concerns on the part of the Bank and other development partners in the wake of the 2005 elections.

This PPAR is based on the relevant documents for the four operations reviewed by the Bank's Board, and other documents relevant for understanding the context of the operations reviewed. They include the Country Assistance Strategies (CASs), the Poverty Reduction Strategy Paper (PRSP), IMF reports, and Economic and Sector Work (ESW) reports. The PPAR is also based on interviews conducted during a mission to Ethiopia in February, 2007, with government officials and members of civil society who were knowledgeable of Bank support in the areas reviewed; with Bank staff at headquarters and in the Addis Ababa office; with IMF staff; and with staff of the resident offices of some of the development partners active in Ethiopia.

Comments from the Bank's Regional Management have been incorporated. The draft PPAR was sent to the Government of Ethiopia for comments following standard IEG procedures but no comments were received.

The report was prepared by Gene Tidrick (Consultant), who assessed these projects 2007/8, under the supervision of James Sackey (Task Manager). Vikki W. Taaka provided administrative support.

Summary

Since the end of the 1998-2000 war with Eritrea, Ethiopia has undertaken reconstruction, stabilized the economy, and restarted structural reforms begun in the 1990s. Despite a severe drought in 2002/03, economic growth averaged 6 percent per annum from 2000/01 through 2005/06 according to official statistics. Macroeconomic management has been prudent during most of this period, and pro-poor budget spending rose from 11.7 percent of GDP in 2001/02 to about 16 percent in 2005/06.

Economic and social progress in recent years is hard to assess because of the weak and inconsistent statistical base. Official estimates show average growth of 6 percent since the end of the war, with growth rates of 10 percent per annum in recent years. The official poverty headcount estimate also shows a decline from 44.2 percent in 2000 to 40 percent in 2005. But these estimates are inconsistent with other indicators, especially with studies casting doubt on the reliability of agricultural growth estimates. Social indicators have mostly, but not uniformly, improved. Access to education expanded dramatically, but at some cost to quality. Infant mortality declined, but average life expectancy has declined in recent years because of HIV/AIDS.

The four operations under review were all critical elements of the Bank's country assistance strategy (CAS), and the CAS itself was aligned with Ethiopia's evolving poverty reduction strategy. The Government prepared an Interim Poverty Reduction Strategy Paper (I-PRSP) in late 2000 outlining reconstruction needs and a program of structural reforms to promote private investment, increase competitiveness in agricultural inputs, and streamline public development expenditure, particularly in health and education. The Bank's Interim Support Strategy (ISS) in November 2000 focused on post-war reconstruction and economic and social rehabilitation. Two of the operations reviewed in this report, the Ethiopian Economic Rehabilitation Support Credit (ERSC) and the Economic Structural Adjustment Credit (ESAC) grew out of the ISS.

In 2002 Ethiopia prepared a full PRSP, known as the Sustainable Development and Poverty Reduction Program (SDPRP). The SDPRP was built on four pillars: (1) Agricultural Development Led Industrialization (ADLI) and food security; (2) governance, decentralization, and empowerment; (3) reform of the justice system and the civil service; and (4) capacity building. The Bank's CAS approved in March 2003 had three thematic objectives meant to support the SDPRP: enhancing pro-poor growth; enhancing human development outcomes by improving governance; and reducing vulnerability. Enhancing pro-poor growth was to be promoted through two sub-objectives: private sector development (PSD) and rural growth. The main instrument proposed for promoting the Bank's objectives was a series of multi-sector budget support operations: Poverty Reduction Support Credits (PRSCs). Three PRSC operations were programmed but only two were completed. The third PRSC was suspended in 2005, along with direct budget support from other donors, because of governance issues.

In the first two operations, stabilization was the main objective. Emphasis varied over time, but a number of reform objectives or components were common to all four operations: public expenditure policy and management; private sector development; and

human development through increased pro-poor spending and better service delivery. In ERSC and ESAC public sector management reform was an objective. PRSC operations included rural development as an important objective.

The ERSC operation was highly successful in promoting its primary objective of stabilization. In conjunction with the Fund's PRGF program, ERSC helped set the stage for sound macroeconomic management for several years in the face of difficult external conditions. The operation also achieved its secondary macro objective of reallocating the budget towards poverty-reducing expenditures. Achievement of the operation's reform objectives was negligible, however. There was little short-term impact and the benchmarks for future action were vague and un-prioritized, and – as became subsequently clear – meant different things to the Bank and the Government. Indeed, the attempt to introduce reform elements in this operation antagonized the Government (which believed Ethiopia had been promised unconditional rehabilitation assistance) and may have set back reform in the longer term by hardening positions prematurely on both sides. Overall outcome is rated *moderately satisfactory*.

Like the ERSC, the ESAC had both stabilization and reform objectives. Design was flawed because stabilization and reform became competing priorities under time pressure created by the urgency of projected balance of payments needs. In the event, stabilization was achieved, but not because of ESAC funding. Effectiveness was inexplicably delayed for more than five months after Board approval. On the reform side, ESAC accomplished more than ERSC but outcomes continued to be mixed. There was inadequate linkage between the actions under ESAC and the previous operation. Expected follow-up actions were downplayed or left out (fertilizer policy, telecom sector policy, privatization), but there was progress in some areas (liberalization of the air cargo market, approval of a new civil service law, and initial steps to address problems of land access and competition policy). Overall outcome is rated *moderately satisfactory*.

The PRSC program was meant to be a series of three single-tranche operations within a medium-term framework. Other donors provided parallel budget support. Each PRSC operation outlined proposed actions and triggers for the next, with the amount varying between \$120 million to \$150 million depending on performance. The PRSC was complemented by a major capacity-building project (PSCAP) and investment projects in other areas, but budget support through the PRSC would gradually replace SWAPs in health and education. Direct budget support was expected to reduce transaction costs, ensure timely donor support, and ensure predictable federal transfers to encourage planning at lower levels. An unspoken aim of direct budget support was to permit “scaling up” of the level of assistance, an objective of the Africa Region for which PRSCs were seen as an important instrument.

Although emphasis varied, each operation had similar areas of focus: public institutional performance, rural development and vulnerability, private sector development (PSD), and human development. It became apparent early on that the Bank and the Government had inconsistent expectations. All of the rural development and PSD issues had been on the agenda of either ERSC or ESAC, and the Bank had hoped to be able to agree to further actions in most of these areas under the PRSC program. The SDPRP had also foreshadowed reforms in these areas. But it was not possible to reach

agreement with the Government on the nature of specific actions. Because of disagreements, particularly over telecom sector reforms, the Bank reduced the amount of PRSC I from \$150 million to \$120 million. Similarly, the Bank reduced the amount of PRSC II to \$130 million because of inadequate progress on PSD and rural development.

The outcome of PRSC I was *moderately satisfactory*. There was progress in strengthening planning and budgeting and in improving institutional performance, and also in expanding budget support and improving governance of service delivery for human development. But outcomes were unsatisfactory for promoting private and financial sector development, and for rural development and vulnerability.

The objectives and design of PRSC II were less relevant than PRSC I. Insufficient account was taken of the lack of progress on private sector development and policy actions were relatively un-ambitious. Achievement of objectives (efficacy) was also less than under PRSC I. Negligible progress was made in improving the investment climate. Progress on public institutional performance slowed and the human development component was mixed. The vulnerability objective, encompassing the rural development and vulnerability component, is also rated modest. The overall outcome rating is *moderately unsatisfactory*.

The main conclusion is that, while the PRSC instrument was a useful instrument in some areas, in Ethiopia there was too much budget support too soon. The overall outcome of the PRSC program is rated *moderately unsatisfactory*. Specific findings are:

- The Bank moved too quickly into direct budget support through the PRSC program. Direct budget support for human development was premature. Despite considerable ESW on PSD, not enough policy dialogue had taken place to develop a shared understanding and compatible expectations between the Bank and the government.
- The Bank also relied too heavily on direct budget support (too much as well as too soon). Heavy reliance on this instrument increased the risk of program failure and led to programs that were too broad and ill-focused to be effective in promoting policy change and institutional development as opposed to resource transfer.
- The complementary PSCAP program increased the effectiveness of the PRSC in public expenditure management. Effectiveness in rural development and education suffered because of the lack of complementary projects and programs.
- The PRSC improved coordination and alignment, but it proved no more flexible than other forms of aid. The program was cut, but not enough, when it turned out that Government support for PSD and rural development was weak. When a major dispute on governance arose, the entire program was terminated.

The main lessons of the review are that:

- Budget support and other program assistance need to be undertaken within a medium-term policy framework. This lesson was learned from the first two operations prior to the PRSC program.

- Complementary investment or capacity building projects may be critical to the effectiveness of direct budget support through a PRSC.
- Successful programmatic budget support through PRSCs requires careful preparation. Prior analytical work and policy dialogue are needed to prevent misunderstandings and inconsistent expectations.
- Direct budget support is high-risk. It is vulnerable to sudden loss of political support from bilateral donors and is no less subject to sudden termination than policy-based lending.

Cheryl W. Gray
Acting Director-General
Evaluation

1. BACKGROUND

1.1 After the overthrow of the Derg regime in 1991, the new Ethiopian Government introduced economic reforms and stabilization measures that reversed economic decline and raised the average growth rate to 6.9 percent during the period 1992-97. The war with Eritrea from 1998-2000 disrupted the Government's development and reform program and the Bank's lending. With the ceasefire in May 2000, the Bank and other development partners resumed support and the Government seemed ready to focus on rehabilitation and development and to resume the economic reform program of the mid-90s.

1.2 The Government prepared an Interim Poverty Reduction Strategy Paper (I-PRSP) in late 2000. The I-PRSP stressed the need to finance emergency rehabilitation programs, provide foreign exchange for immediate import needs, and reduce domestic borrowing. Stabilization required a sharp reduction in military spending and access to significant foreign financing. The I-PRSP also outlined structural reforms to promote private investment, increase competitiveness in agricultural inputs, and streamline public development expenditure, particularly in health and education. In 2002 Ethiopia prepared a full PRSP, known as the Sustainable Development and Poverty Reduction Program (SDPRP). The SDPRP was built on four pillars: (1) Agricultural Development Led Industrialization (ADLI) and food security; (2) governance, decentralization, and empowerment; (3) reform of the justice system and the civil service; and (4) capacity building.

1.3 The Bank's country assistance strategy was aligned with Ethiopia's evolving poverty reduction strategy. The Bank's Interim Support Strategy (ISS) in November 2000 focused on post-war reconstruction and economic and social rehabilitation. It proposed an emergency assistance program of four operations amounting to \$700 million over two years, plus investment lending of about \$200 million. Two of the operations reviewed in this report, the Ethiopian Economic Rehabilitation Support Credit (ERSC) and the Economic Structural Adjustment Credit (ESAC) grew out of the ISS. The Bank's Country Assistance Strategy approved in March 2003 endorsed the four pillars of the SDPRP. Bank strategy was summarized in three thematic objectives: enhancing pro-poor growth; enhancing human development outcomes by improving governance; and reducing vulnerability. Enhancing pro-poor growth was to be promoted through two sub-objectives: private sector development (PSD) and rural growth. The main instrument proposed for promoting the Bank's objectives was a series of multi-sector budget support operations: Poverty Reduction Support Credits (PRSCs), two of which are under review here.

1.4 A number of core objectives or components were common to all four operations: public expenditure policy and management; private sector development; and human development through increased pro-poor spending and better service delivery. Table 1 summarizes the main components of the operations.

Table 1. Components of Operations

	<i>ERSC</i>	<i>ESAC</i>	<i>PRSC I</i>	<i>PRSC II</i>
Macro stabilization	X	X		
Public sector management/reform	X	X		
Public expenditure policy/management	X	X	X	X
Private sector development	X	X	X	X
Rural development			X	X
Human development/pro-poor spending/service delivery	X	X	X	X

Overview of Economic and Social Progress

Growth and economic management

1.5 Ethiopia continued its traditional prudent macroeconomic management during most of the period since the end of the war. Performance under an IMF PRGF facility during 2001-4 was good. All the quantitative and structural performance criteria required for completion were achieved. Ethiopia also reached the completion point for the HIPC Initiative in April 2004, which reduced external debt and brought scheduled debt service obligations to more manageable levels. During 2005, following the electoral crisis, external assistance was reduced and macroeconomic management began to deteriorate. By early 2007 inflation was running at about 17 percent, the trade deficit had reached about one-fourth of GDP, and foreign exchange reserves were less than two months of imports. Table 2 shows selected macroeconomic and performance indicators for the past several years.

1.6 According to official statistics, growth of GDP has averaged nearly 6 percent per year during 1998/99-2005/06. In per capita terms this implies annual average growth of about 3 percent, an increase of about one-fourth over the entire eight-year period. In the past three years overall growth has averaged 10 percent.

1.7 There are reasons to believe that growth rates in recent years have been overestimated, however, particularly for agriculture.¹

- Despite high growth estimates for agriculture, food prices have increased at double-digit levels. This is unusual in periods of recovery from drought.²

¹ Some resident staff from other development partner agencies estimated that total GDP growth in the past three years may have been more on the order of 6-7 percent per year rather than 10 percent. This is only an “informed guess”, however, and is not based on survey data. The IMF staff report on Article IV consultations in 2007 noted that, “The data provided to the Fund are adequate for surveillance purposes, but major weaknesses persist and further steps should be taken to address the shortcomings in real, fiscal, and balance of payments statistics without delay.”

² The Africa Region has commented: “there are numerous studies being carried out by academics in Ethiopia and Bank staff to precisely understand this unusual phenomenon—not one of them has found that the cause is exaggerated production numbers... some independent sources (e.g., FAO) have found that cereal production has increased faster than what the government statistics (i.e. Central Statistical Agency-CSA) show, and others (e.g., Bellmon) have found the opposite. A Bank report on ‘food price inflation,’

- Agricultural production figures are based not on sample surveys but on estimates given by local officials who have an incentive to report good results.
- Growth of value added in agriculture (the relevant concept for GDP) has not kept up with growth of agricultural output. Taking account of input costs, net farm income has not grown commensurately with gross income. The Bank's draft report on Policies for Pro-Poor Agricultural Growth (February 2007) shows that, based on currently usage patterns, fertilizer use does not appear to be profitable; farmers are losing money.³

shared the concern that CSA's methodology does suffer from non-sampling errors, but concluded that it is nevertheless the most accurate, timely and cost-effective technique for estimating crop production in Ethiopia on a regular basis.

³ The Africa Region has commented that "what has been left unstated is that farmers in Ethiopia don't pay market prices for inputs—there is considerable subsidy involved in various forms. Second, various studies on 'food price inflation' have found that farmers are now more organized through cooperatives and are able to better bargain with the factor suppliers as well as the buyers of their produce. Independent field surveys, commissioned by the Bank, have shown significant increases in farmer welfare, in diverse regions, consistent with officially reported growth. The evidence thus suggests that farmers' margins are improving and not falling in Ethiopia." This comment is not relevant to the argument about GDP growth, but it has significant implications for poverty. Subsidies are consistent with low value added and low value added means that GDP growth would be overestimated. Indeed, if there is negative value added (value subtracted), growth of gross output would actually lower GDP. But if inputs are subsidized and margins are improving, then gross output growth should reduce poverty.

Table 2. Ethiopia: Selected Macroeconomic and Performance Indicators 1998/99 - 2005/06

	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06
(Change in percent)								
Real GDP at factor cost	6.0	5.3	7.4	1.0	-3.3	11.9	10.5	9.6
Agriculture and related	3.8	3.2	10.6	-2.1	-11.4	17.3	13.4	11.2
Non-agriculture	7.8	7.6	4.4	4.0	4.0	7.8	8.1	8.2
Exports f.o.b.	-	0.4	-4.7	-2.4	6.7	36.8	36.3	17.6
Imports f.o.b.	-	3.4	-3.4	8.9	9.5	39.4	40.4	26.4
Terms of trade (- deter.)	-15.9	-33.9	-3.1	-10.1	-6.5	-14.7	10.8	
Consumer price index	4.8	6.2	-5.2	-7.2	15.1	8.6	6.8	12.3
(Percent of GDP)								
<i>External sector</i>								
Exports goods & NFS	14.1	12.5	12.4	12.6	14.2	15.8	16.1	15.8
Imports goods & NFS	29.0	25.0	24.6	27.9	29.2	33.5	38.4	40
External acct. bal. (excl. official transfers)	-11.2	-7.9	-7.9	-9.4	-8.8	-10.2	-13.4	-16.9
<i>Government finance</i>								
Revenue	18	14.9	15.5	16.4	16	17	15.8	16.9
Tax revenue	11.3	10.1	11.3	12.5	12	13.3	12.6	12.2
External grants	3.3	2.7	4	3.8	6.6	4.9	4.6	3.2
Expend. & net lending	31.7	26.9	23.4	27.8	29.7	25.1	25.2	25.4
Defense	8.9	10.7	5	4.2	3.4	3.0	3.0	2.6
Social Expenditure	3.9	3.3	3.4	4.4	4.6	4	3.9	4.3
Fiscal balance (incl. Grants)	-10.4	-3.9	-5.1	-7.6	-7.1	-3.2	-4.7	-5.2
<i>Other indicators</i>								
Gross reserves (months of imports)	2.7	2.2	2	3.4	3.7	3.8	3.5	2.5
Private investment (% of GDP)	8.9	10.7	9.3	11.7	12.2	12.4	11.4	11.4
Poverty headcount ratio, official estimate (% of population)		44.2					38.7	

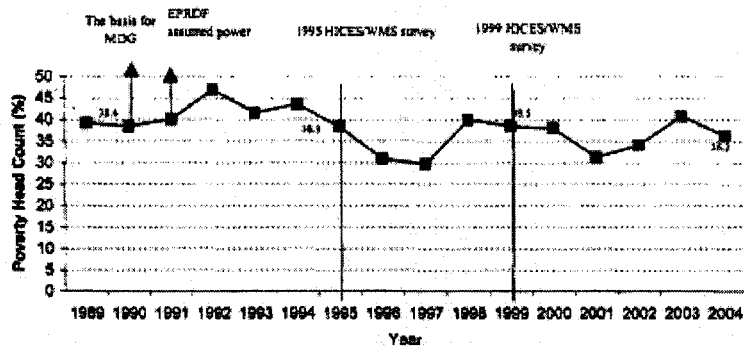
Sources: IMF, Ethiopia Selected Issues and Statistical Appendixes 2005, 2006 and 2007, based on Ministry of Finance and Economic Development, and Fund staff estimates

1.8 One significant achievement was the reallocation of the budget towards pro-poor sectors. (In Ethiopia, the pro-poor sectors are defined as: education, health, agriculture and food security, roads, and water and sanitation.) Pro-poor spending as a share of GDP rose from 11.7 percent in 2001/02, the first year after the war with Eritrea, to about 16 percent in 2005/06.

Poverty Reduction

1.9 Just as there is uncertainty over the growth rate, so is there uncertainty over poverty trends. The Bank's Poverty Assessment (Well-Being and Poverty in Ethiopia) estimated that poverty incidence in Ethiopia (using a national poverty line equivalent to \$1.50 per day in 1993 PPP) declined only marginally between 1990 and 2004 – from 38.4 percent to 36.2 percent. Overall, poverty incidence has been volatile with no discernible trend during the entire period. Since poverty incidence was almost identical in 1990 and 1999, a similar marginal decline (from 38.5 percent to 36.2 percent) occurred during 1999 – 2004.

Figure 1. The Incidence of Poverty, 1989-2004



Source: World Bank (2005)

1.10 Household survey data, however, show a more substantial drop in the poverty headcount from 44.2 percent of the population in 1999/2000 to 38.7 percent in 2004/2005 (See Table 2.). The methodology has not yet been verified, but if a decline of this magnitude did take place and is sustained, it would be a significant accomplishment. Evidence from other sources is mixed. An ongoing panel study done for the Bank⁴ shows a decline in the rural poverty headcount from 50 percent to 43 percent between 2000 and 2004, and a drop in the urban poverty headcount from 45.2 percent to 40.0 percent during the same period. A participatory poverty assessment⁵ commissioned by the Government and undertaken during the same period as the household survey does not point to substantial improvements. A rural survey done by the Bank in 2006 found that rural households reporting changes in income in the past year (when agricultural growth was over 11 percent) were about equally divided among those reporting an increase, those reporting a decrease, and those reporting no change.

1.11 There are several reasons why poverty reduction may have been limited.⁶

- Harvest failure in 2003 threatened about 14 million people with famine. This not only caused a spike in the incidence of poverty in that year, but also had longer-term effects because of loss of livestock and other assets.
- Growth has been disproportionately driven by the service sector. According to the Bank's Poverty Assessment, real annual per capita growth in services from 1992-2004 was 6.8 percent vs. -0.25 percent in agriculture. Within services,

⁴ Bigsten and Shimeles, Chronic poverty, vulnerability and the persistence of poverty in Ethiopia: 1994-2004, University of Gothenberg for the World Bank (December 2006)

⁵ Ellis and Woldehanna, Ethiopia Participatory Poverty Assessment 2004-05, a paper commissioned by MoFED

⁶ The Africa Region has commented that "of the four reports {mentioned}—Bank's Poverty Assessment; GoE's household survey results; Bigsten and Shimeles; and Ellis and Woldehanna—two found that the poverty headcount ratio has fallen significantly while the other two found that the decline has been much more modest."

government services (public administration, health, education, and defense) grew most rapidly (10.2 percent per capita from 1992-2004), and up to 2000, military expenditure grew especially rapidly. Since 2000, defense expenditure has declined while poverty-reducing spending has increased. This should be more favorable for long-term growth, but there are still issues about the effectiveness of poverty-reducing expenditure, e.g. the share going to expansion of government employment and recurrent expenditure (“Public Sector Reform, Decentralization and Governance in Ethiopia”, background paper for Country Assistance Evaluation). Government services have continued to be the fastest-growing sector, contributing 13 percent of incremental GDP during 1998/9-2005/6. If agricultural growth proves to be overestimated, the government services share of incremental growth would be even higher.⁷

- Lack of rural-urban mobility has restricted opportunities for income diversification for the 85 percent of Ethiopians who live in rural areas. Diversification and off-farm income growth have been the main way out of poverty for rural households in most of the world. In Ethiopia, too, the share of off-farm income is negatively associated with poverty incidence (see Ellis and Woldehanna), but the government’s land tenure policy has created a sense of insecurity which deters diversification and rural-urban mobility.

1.12 Ultimately, the extent to which poverty was reduced may depend in large part on how fast agriculture has been growing.⁸

Social indicators

1.13 Social indicators have mostly, but not uniformly, improved in recent years. In education, access has improved substantially, but the pupil/teacher ratio has increased (Table 3). In health, infant mortality and maternal mortality have both declined (Table 4), but life expectancy first increased from the 1997 baseline of 52 years to 54 years in 2001/02, and then dropped to 48 in 2005. Access to improved sources of water declined from 23 percent in 1990 to 22 percent in 2006, and per capita water consumption in Addis Ababa fell by 25 percent between 1998 and 2005.

⁷ The Africa Region has commented that the argument above is misleading: “First, not all education and health services in Ethiopia are publicly funded. Second, rapid growth of educational and health services, whether publicly or privately funded, are neither a bad thing nor are they completely devoid of any impact on poverty. Third, the share of government consumption (correctly defined) to national GDP in Ethiopia has been steadily falling and not rising as claimed by PPAR. Fourth, several years of double digit growth and relatively equitable distribution are fully consistent with significant poverty declines.”

⁸ Subsidies can weaken the link between output growth and poverty, however. See footnote 3, above.

Table 3. Trends in the Education Sector

Indicator	1999/2000	2000/2001	2001/2002	2002/2003	2003/2004	2004/2005
Financing						
Education Share of Total Public Exp (%)	10	14	15	17	21	20
Education Share of Total Public Exp (%)	10	14	15	17	21	20
Primary's Share of Education Budget (%)	61	63	66	56	61	65
Access						
Primary GER (1-8)	51	57	62	64	68	79
Female		47	51	54	59	71
Male		67	72	75	77	88
Secondary GER (9-10)		13	16	19	22	27
Female		11		14	16	20
Quality						
Pupil/Teacher Ratio (Grade 1-8)	64	64	70	70		72
Certified Teachers Grades 1-4 (%)	90	97	96	97		99
Student/Textbook Ratio			3:1			2:1
Efficiency						
Grade 1 Drop Out Rate	30	28		29		23
Primary Drop Out Rate	19	18		17		15
Gr 4-8 Repetition Rate		13	10		11	10
Equity						
Gender Gap GER Primary		20	21	21	18	17
Gender Gap GER Secondary		2		5	6	7
Primary GER in Most Underserved Areas	9	11		15		17
Share of Female Primary Teachers	28	30	31	31		36

Source: ESDP Documents; FMOE Statistical Annual Abstracts

Table 4. Achievements in the Health Sector

Indicator	1999/ 2000	2004/2005
Public Health Exp. (US\$ per capita)	5.6	7.1
PHC Service Coverage (%)	45*	70*
Contraceptive Prevalence Rate (%)	8.1	14.7
Total Fertility Rate	5.9	5.4
Maternal Mortality (/100.000)	871	673
Infant Mortality (/1000 births)	97	77
Under -five Mortality (per 1000)	166	123
Underweight Children (%)	47	38
Immunization Coverage (%)		
DPT3	21	32
Measles	27	35

Source: DHS 2000/2005; Note: * Derived from PASDEP

2. ECONOMIC REHABILITATION SUPPORT CREDIT

Background

2.1 Near the end of the 1998-2000 Ethiopian-Eritrean War, the President of the Bank, Mr. Wolfensohn met with Prime Minister Meles Zenawi to discuss possible Bank assistance for post-war reconstruction. The talks were informal, but a “gentlemen’s agreement” was reached that the Bank would provide \$700 million of fast-disbursing assistance after the war ended. The amount discussed was very specific, according to Country Team members in a position to know. Discussion of post-war policy was vague and less conclusive.

2.2 The Bank’s Interim Support Strategy (ISS) of November 2000 proposed a \$700 million emergency post-conflict support package which was to become effective when a peace agreement was signed on December 12, 2000. Included in the package were four lending operations: Emergency Demobilization and Reintegration Project (\$170 million, approved November 2000); Emergency Recovery Program (\$230 million, approved November 2000); Fertilizer Supplemental (\$55 million, approved June 14, 2001) and Emergency Support Credit (proposed to be \$250 million). During and after Board discussion of the ISS a number of executive directors expressed their preference for making the Emergency Support Credit (ESC) a policy-based rather than an emergency operation. At the concept review meeting in January 2001 for the proposed ESC, it was decided to change the operation from emergency to policy-based and to split it into two single-tranche credits extending over a longer period of 12-18 months. The rationale for these changes was that they would provide urgently-needed assistance in the short-term and give time to reach agreement on and begin implementing a medium-term program of structural reform. The two single-tranche credits that finally emerged were the ERSC (\$150 million, approved June 5, 2001, and the ESAC (\$120 million, approved June 18, 2002).

2.3 The changes did not take place smoothly. The Government felt that it was premature to define a structural reform program so soon after the war and while preparations for a full PRSP were ongoing and, furthermore, believed that the Bank was acting in bad faith in seeking to impose conditionality for what it regarded as an agreement to provide \$700 million of emergency funding. The Region concluded that the program that emerged after appraisal was too weak to be considered a policy-based loan and recommended that the ERSC be classified as a rehabilitation credit rather than an adjustment operation. But the operation did include some policy reforms and indications of future reforms, and the Region saw the ERSC as a bridge to future policy-based lending.⁹

⁹ At the time, the Region expected to move straight on to a PRSC program following a full PRSP and CAS to be completed in FY 02.

Objectives and Components

2.4 The objectives of the ERSC were:

- *Stabilization*. The President's Report stated that the credit supported "the Government's efforts in stabilizing the economy and moving back to a sustainable path of growth, as a necessary condition for poverty reduction." This included as a secondary objective for reallocation of public spending towards poverty-reducing expenditure.
- *Support reforms* in (i) public sector management; (ii) public expenditure policy and management; and (iii) private sector development (PSD) and export competitiveness.

2.5 The reform measures supported under ERSC were meant to complement reforms under the IMF PRGF. The PRGF included modest reforms in the trade and foreign exchange regimes, the financial sector, and tax policy and administration. The policy matrix from the ERSC President's Report (report number P7441-ET, April 30, 2001) is included as Annex A. The *public sector management* sub-objective of the ERSC supported the Government's civil service reform program and included components on: strengthening the legal framework; performance incentives; improving service delivery; and enhancing the transparency of personnel management systems. The *public expenditure policy and management* sub-objective included components to support the Government's Expenditure Management and Control Program, and to strengthen social service delivery. The *PSD and export competitiveness* sub-objective included components to remove regulatory constraints on investment; promote exports; continue privatization of parastatals; and increase agricultural productivity by reforming fertilizer policy. Several issues were identified for future action: removing the ban on exports of hides and skins, taking steps to attract direct foreign investment; enhancing the regulatory framework and competition for utilities (including telecommunications); and improving the urban land market.

Relevance of Objectives and Design

2.6 The operation was highly relevant to the stabilization objectives. Bank funding exceeded that of the IMF and became more important for meeting Ethiopia's financing gap than projected because of a fall in coffee prices. Relevance of design was ensured by IMF monitoring within a three-year macro framework under the PRGF. The operation and its design were also relevant to the secondary objective of reallocating public expenditure towards poverty-reducing sectors. The project both provided significant resources for budget planning and sought to improve budget management.

2.7 Stabilization was the dominant, and certainly the most urgent, objective. The economy was recovering from a drought and a sharp deterioration in terms of trade, as well as suffering from destruction and dislocation from war. The IMF had approved a three-year arrangement under PRGF in December 2000. This provided funding of \$111 million and established an agreed macroeconomic framework for which the \$150 million of fast-disbursing assistance from the Bank was a critical part of the financing plan. The ERSC was intended to help the Government reduce domestic financing of the deficit and

rebuild foreign exchange reserves, and would finance increased private sector imports in line with the removal of restrictions in the foreign exchange market.

2.8 Poverty-targeted expenditures had been crowded out during the war. Reallocation depended mainly on reduced defense spending which was scheduled to fall from 13.3 percent of GDP in 1999/2000 to 7.3 percent in 2000/01, while poverty-targeted spending was scheduled to rise from 8.6 percent of GDP to 12.1 percent in the same period. The ERSC was to support this reallocation by helping to increase the overall resource envelope and by using projections of further increases in subsequent years as benchmarks for future operations.

2.9 Relevance to reform objectives was more mixed. The operation supported some concrete policy measures that could plausibly be expected to support PSD and increase exports (including privatization, duty exemptions for exports, enhanced export credit guarantees, and reduction in export regulations). It also included as a prior action adoption of a draft Civil Service Law to support better public sector management through civil service reform. But many prior actions were to initiate studies, develop action plans, or set up committees. These could help identify important areas and initiate a process for future reform, but the nature of future actions often remained to be defined. Benchmarks for actions also remained vague, with a few exceptions such as the benchmark to allow foreign private sector participation in the Ethiopian Telecommunications Corporation before the end of 2002/03. With 43 benchmarks for 2001/02 and 28 for 2002/03, the indicative future program was broad and un-prioritized.

2.10 The overall rating of relevance of objectives and design is *substantial*.

Achievement of Objectives (Efficacy)

Stabilization:

2.11 The operation made an important contribution towards its primary objective of stabilizing the economy. The credit became effective and disbursed the full \$150 million on July 5, 2001, one day before the end of the fiscal year, thus helping to reduce domestic financing from 8.4 percent of GDP in 1999 to 0.9 percent in 2000/01. The volume of imports decreased only 1.9 percent (compared to a fall of 17.9 percent the previous year) despite continued deterioration in the terms of trade and a degree of import liberalization. GDP growth increased and consumer prices actually fell, mainly due to a good harvest and food aid imports, but also due in part to sustained import levels for the non-agricultural sector. Reserves did not increase as planned, but rather fell slightly to only 2 months of imports. Finally, there was a significant budget reallocation towards poverty-targeted expenditures which rose from 8.2 percent of GDP in 1999/2000 to 11.7 percent in 2000/01, slightly short of the target of 12.1 percent. Support for stabilization was both effective and timely, and overall progress in achieving the stabilization objective was *high*.

Reform

2.12 The broad reform objectives underlying the ERSC were both to support actions which might have a significant short-term impact and to help define an agenda for further reforms in subsequent operations over the medium term. Neither objective was met.

2.13 *Public sector management.* The Government adopted a new civil service law and approved a national service delivery policy as agreed prior actions. Both of these were useful steps that were followed up in ESAC and the PRSC program. But the Government undermined a plan to restructure civil service salaries by raising the pay of the lowest salary grades. A major program of decentralization was also launched in 2001. This significantly increased the complexity of public sector management and of public expenditure management.

2.14 *Public expenditure management.* The ICR for ERSC and ESAC (report number 27570, December 19, 2003, p.13) concluded: “This component is rated *unsatisfactory* for both credits because the intent of the component has not been advanced despite the eventual compliance with most of the credits’ prior actions. Whereas ERSC appraisal identified a number of critical measures to achieve the strategic aim of linking planning and budgeting to policy choices, these measures were not taken up as prior actions under either credit, but were left for future years. Three full budget cycles on, the key ones – adherence to the financial calendar and development of an action plan for the public expenditure program (PEP) – have still not started.” Essentially, the Government and the Bank started afresh to try to address public expenditure management issues under the PRSC.

2.15 *Promoting PSD and export competitiveness.* The one area in which measures were taken that might have been expected to produce quick economic benefits was export promotion. As it turned out, there was little short-term supply response or significant longer-term impact. A bonded warehouse scheme was introduced but produced almost no response (one firm in three years). Under an export credit guarantee scheme, the National Bank of Ethiopia issued only 17 guarantees, of which 5 defaulted, and only 10 supplier’s credits were issued. A quality certificate for exports continued to be required, contrary to conditionality. In the case of PSD, the privatization program slowed and then stalled for several years rather than progressing as planned. This was partly due to poor design and implementation but also reflected Government ambivalence. Finally, the proposed measures to increase private participation in fertilizer marketing, which were meant to reverse trends under the failed National Fertilizer project, also failed to take place.

2.16 Overall efficacy of the reform objective was *negligible*. Based on the dominance of the stabilization objective and the separate ratings for stabilization and reform, overall efficacy is rated *substantial*.

Outcome

2.17 The ERSC operation was highly successful in promoting its primary objective of stabilization. In conjunction with the IMF’s PRGF program, ERSC helped set the stage for sound macroeconomic management for several years in the face of difficult external

conditions. The operation also achieved its secondary macro objective of reallocating the budget towards poverty-reducing expenditures. Achievement of the operation's reform objectives was negligible, however. There was little short-term impact and the benchmarks for future action were vague and un-prioritized, and – as became subsequently clear – meant different things to the Bank and the Government. Indeed, the attempt to introduce reform elements in this operation antagonized the Government and may have set back reform in the longer term by hardening positions prematurely on both sides. Overall outcome is rated *moderately satisfactory*.

RISKS TO DEVELOPMENT OUTCOMES

2.18 The President's Report identified four risks: economic shocks such as further deterioration in the terms of trade; resumption of hostilities with Eritrea; weak capacity in the public and private sectors; and a weakening commitment to reform. Three of these adverse developments took place: the terms of trade continued to deteriorate until 2004/05, and more importantly, a severe drought took place in 2002/03, capacity proved to be an obstacle to progress on improving public expenditure management and reforms such as privatization; and commitment to some reforms proved to be weaker than anticipated by the Bank. The macroeconomic management accomplishments turned out to be quite robust in the face of economic shocks. Ethiopia completed the PRGF program and continued sound macro management for about four years. More recently (since late 2005) the IMF has expressed some concerns about the effectiveness of management. The shift towards poverty-reducing expenditure seems well-entrenched, though there are issues about the effectiveness of such expenditure. The risk to development outcomes for stabilization and macro management are *moderate*.

2.19 On the reform side, little was accomplished in this operation to be placed at risk, but if the focus is placed on the risk that development outcomes will not be realized (and not just maintained), then risk to development outcomes for reforms should be rated *significant*.

2.20 Given the heavy weight of the stabilization objective, the overall risk to development outcomes is rated *moderate*.

Monitoring and Evaluation Design, Implementation, and Utilization

2.21 *Design.* Macro indicators were conventional and well-established. The definition of poverty-targeted expenditure (health, education, agriculture, and roads) was simple and understandable, if broad, but the indicator was only an input. Indicators of reform were mostly outputs, and some of the outputs were ill-defined. Overall, the design was *modest*.

2.22 *Implementation.* In effect, implementation of macro monitoring was done by the IMF through reviews of the PRGF program. Prior actions under the operation included the launch of a study of poverty incidence and trends and the launch of a work program to analyze the impact of Government policies and programs on the poor. Little attention seems to have been given to creating a results framework for reform components. Given the overall focus on stabilization and budget allocation, implementation is rated *substantial*.

2.23 *Utilization.* The IMF clearly used macro indicators to update and adjust the macro program of PRGF. The Bank continued to focus on interpretation of compliance with reform output indicators. Use of M&E for preparation of the next operation was minimal because of inadequate design of indicators. Rating: *modest*.

2.24 The overall rating for M&E is *modest*.

Bank Performance

2.25 The Bank was under considerable pressure to move quickly during preparation of ERSC because of urgent financial needs. The decision to create a smaller one-tranche operation was driven partly by time pressure. The decision to try to incorporate policy elements into the operation complicated preparation, dialogue with the Government, and coordination with other donors. IEG agrees with the ICR assessment: “The Bank should have explicitly recognized that ERSC could not be a policy reform credit.” Because of this decision, and the poor design of reform elements, quality at entry is rated *moderately satisfactory*.

2.26 The supervision mission identified some delays in implementation that were attributed to lack of capacity and lack of high-level attention. This was partly correct, but the mission seems to have misjudged the extent to which the Government was committed to reforms in some areas. Quality of supervision is rated *moderately satisfactory*. Overall Bank performance is rated *moderately satisfactory*.

Borrower Performance

2.27 The Government resisted both the decision to split the originally planned operation into two single-tranche credits and the decision to incorporate policy conditions, and the Government delayed some important decisions until late in the processing cycle. Implementation of the macro program, including reallocation towards poverty-reducing expenditure, was strong and continued to be sustained after the operation. Implementation of the agreed reform program was mixed. The Government complied with most prior actions, though often with some delays. Overall borrower performance is rated *satisfactory*.

3. ETHIOPIA STRUCTURAL ADJUSTMENT CREDIT

Background

3.1 The ESAC was presented to the Board about one year after the ERSC, and provided the last installment from the \$700 million emergency assistance envisioned in the ISS. Macro management had been sound and Ethiopia continued to meet the program targets and benchmarks under the PRGF arrangement with the Fund, but the amount of the ESAC was increased from the originally-planned \$100 million to \$120 million to help offset a projected increase in the external deficit due to the more difficult international environment after the events of September 11, 2001.

3.2 The PRSP had not been completed so there was no CAS in place as had originally been hoped, and therefore there was no possibility of introducing a Poverty Reduction Support Credit (PRSC) program at this stage. Preparations for the PRSP were well-advanced, but it had been delayed due to an extensive consultation process and a struggle within the ruling party over the direction of economic policy. At a party conference in September 2001 the reform faction led by the Prime Minister gained the upper hand and the Government seemed set to introduce a program of gradual but extensive reforms. In the Bank's view there was no question but that the ESAC should be policy-based. The Government still resisted conditionality and there were delays in reaching agreement on some issues. Because of the urgency of projected financing needs, the approach of the end of the fiscal year for both the Bank and the Government, and a closing window for allocation of IDA, the Bank's bargaining position on policy issues was weak. It came as a surprise, therefore, that after Board approval on June 18, 2002, the Government delayed taking steps to make the credit effective until November 28, 2002, more than five months later.

Objectives

3.3 Like the ERSC, the ESAC had both stabilization and reform objectives. According to the President's Report (Number P7521-ET, May 15, 2002): "The proposed Credit supports Government's efforts in stabilizing the economy and achieving a sustained path of growth... The ESAC focuses on economy-wide reforms aimed at improving the investment climate for the private sector, in support of the Government's pro-poor growth strategy; deepening civil service reforms and strengthening public expenditure management to improve the quality of public services delivery."

3.4 The policy matrix set out the objectives and their main components or prior actions as follows (see Annex B):

- *Maintaining Poverty-Focused Macroeconomic Policies.* This included prior actions to

- Sustain good macro performance
 - Make further increases in allocations to poverty-targeted sectors in the 2002/03 draft budget
 - Prepare a full draft PRSP
- *Promoting Private Sector Development* through various actions to
 - Improve the business environment
 - Reduce transactions costs
 - Increase export competitiveness
 - *Improving Public Sector Management and Service Delivery* through components aimed at
 - Strengthening the legal framework for civil service reform
 - Improving expenditure management
 - Enhancing performance incentives
 - Improving fiscal monitoring and accountability

3.5 As in the ERSC, the reform objectives included both prior actions and indications of future directions. “Future operations will emphasize the deepening of these [PSD and public sector management] reforms, in the areas of further private sector growth, decentralization and empowerment, capacity building, infrastructure and human development.”

Relevance of Objectives and Design

3.6 The stabilization objectives of the operation appeared as relevant as under ERSC. The Government had made progress on stabilization but the situation was fragile because of the external environment. ESAC was intended to help keep macro management on track in conjunction with IMF monitoring under the PRGF. Support for continued increases in budget allocations towards poverty-targeted sectors also remained relevant.

3.7 Reform objectives were also mainly relevant in the sense that Ethiopia needed to restart and extend reform in areas addressed in ESAC in order to achieve a sustained path of growth in the medium-term. But design was flawed because stabilization and reform became competing priorities under time pressure. The perceived urgency of providing financing for stabilization left too little time to agree on a properly prioritized and sequenced reform framework. Although ESAC was supposed to support the continuation of reforms begun under ERSC and the policy matrix headings were similar, prior actions for ESAC did not include several important actions identified under ERSC to be taken before the end of 2001/02. These included fertilizer marketing reform, elimination of case by case screening of investments, elimination of a ban on exports of hides and skins, allowing foreign private sector participation in the Ethiopia Telecommunications Corporation, and some areas of public expenditure management reform. Prior actions were included on two key issues identified in ERSC, however – competition policy and urban land policy.

3.8 A two-stage review of quality at entry by an internal review panel (QAG) rated quality at entry as marginally satisfactory. The main criticisms of design were:

- Inadequate linkage between the actions under ESAC and the previous operation. Despite being billed as the second tranche of ERSC, there were no clear priorities for follow-on action of the ESAC from ERSC. Nor were there triggers for onward linkage to the PRSCs.
- Lack of a medium-term framework that sets out the logic and sequencing of measures from one operation to another.
- Weak prior actions.
- Unclear implementation arrangements, e.g. the absence of baseline indicators and interim benchmarks for M&E.
- Inadequate assessment and mitigation of risks, particularly in terms of capacity for implementation of reforms.

3.9 These criticisms were largely justified and reflect the competing priorities of stabilization vs. reform, and the time pressure the former generated. Priorities and implementation arrangements were left to be defined in the PRSP which was still under preparation. Under these circumstances it might have been better to have focused on a smaller number of prior actions with more immediate economic impact.¹⁰ Overall relevance is rated *modest*.

Achievement of Objectives (Efficacy)

Stabilization

3.10 Objectives such as an increase in reserves (from 2 months of imports to 3.2 months) and in pro-poor spending (up from 11.7 percent of GDP in 2000/01 to 14.6 percent in 2002/03) were exceeded in 2001/02, but could not be attributed to ESAC. The long and inexplicable delay in effectiveness meant that the ESAC did not disburse until mid-way through the 2002/03 fiscal year.¹¹ Funding was still useful at that point since Ethiopia faced another severe drought in 2002/03, but ESAC did not provide the quick finance which had been intended. Despite the delay in effectiveness, overall efficacy of stabilization under ESAC was *substantial*.

Improving the investment climate for the private sector

3.11 The component on *business environment* addressed some important new issues. As a prior action, the Government issued a Trade Practices Proclamation creating a Competition Commission and establishing rules on anti-competitive practices, abuse of market dominance, and consumer protection. The rules still allowed for application of discretion to any enterprise designated an exception by the Government, and did not address the still contentious issue of privately owned but party-affiliated enterprises (the “party-statals”), but it was a step forward in an important area. A new Urban Land Law was also approved by Parliament. Again, this was a useful step forward in trying to resolve a major (and still unresolved though somewhat improved) constraint on PSD.

¹⁰ Ten prior actions were legally binding. (These are indicated in bold face in the policy matrix reproduced in Annex C.) These were not necessarily the most important actions in terms of economic improvement nor had they all been identified by the ERSC for early implementation.

¹¹ The Government may have realized by the time of approval that financing was no longer urgent due to higher than anticipated grants and debt relief received.

Finally, the investment code was revised under ESAC to help promote foreign investment, though the code only allowed investors to form joint ventures with the Government telecom services and at first still required investors to obtain investment permits.

3.12 The component on *transaction costs* required the Ethiopian Shipping Lines to reduce tariffs but did not end its monopoly status. But the Ethiopian Airlines' protection in the cargo market was abolished, resulting in substantial reductions in shipping costs and giving a significant boost to emerging horticultural exports.

3.13 The component on *export competitiveness* supported further steps on creating a bonded warehouse and improving export finance, though as noted in the discussion of ERSC above, there were few concrete results. Studies of coffee marketing and restrictions on hides and skins were undertaken but implementation was delayed, and the ERSC prior action to waive the requirement for quality certificates for exports was still not implemented.

3.14 As noted above, some reforms begun under ERSC for which further action was slated in 2001/02 were downplayed or left out (fertilizer policy, telecom sector policy, privatization), but starting to engage on competition policy and land access was an important step, and the liberalization of the air cargo market had a direct and beneficial impact on exports. Overall progress on improving the investment climate is rated *modest*.

Deepening civil service reform and improving public sector management

3.15 The *civil service reform* (strengthening the civil service strategic and legal framework) component continued to make some progress under ESAC. A new Civil Service Law was approved by Parliament in December 2001 and the Council of Ministers approved a civil service grievance system. On the *public sector management* component the negative assessment quoted from the ICR applied both to ERSC and ESAC: there was formal compliance with conditionality but little real progress. For example, the Council of Ministers approved a Macroeconomic and Fiscal Framework (MEFF) and issued indicative planning figures, but only late in the fiscal year for two years running. Integration of federal and regional recurrent and capital budgets was also not accomplished. In the remaining sub-components, a job classification and grading scheme was completed but remained to be implemented; a draft remuneration policy was developed, but was not used; and about two-thirds of personnel records were automated. Overall progress on this objective is rated *modest*.

3.16 On the basis of the above, the overall efficacy of ESAC is rated *modest*.

Outcome

3.17 ESAC was only partly successful in achieving its stabilization objective. Although relevance remained high, implementation was weakened because of the delay in effectiveness. Ethiopia met most of the stabilization targets and exceeded the target for reallocation towards poverty-reducing expenditures without Bank support in 2001/02, but the fast-disbursing funds provided important support in 2002/03 as a drought

developed. On the reform side, ESAC accomplished more than ERSC but outcomes continued to be mixed. Overall outcome is rated *moderately satisfactory*.

RISKS TO DEVELOPMENT OUTCOMES

3.18 The President's Report noted that while the risk of renewed conflict with Eritrea had diminished since the previous operation, vulnerability to economic shocks remained high. The Bank also emphasized the risks from institutional and fiduciary weaknesses. The ESAC itself could do little to mitigate capacity risks in the short run, but a Country Financial Accountability Assessment (CFAA) and Country Procurement Assessment Review (CPAR) were under way and the Bank and Government were discussing a capacity building project for the medium-term. The President's Report also noted that the lack of immediate results might weaken political commitment. As discussed above for the ERSC, the Government's commitment to sound macro management and reallocation towards poverty-reducing sectors has proved to be strong in the face of economic shocks. With respect to reforms, capacity and commitment continue to pose significant risks to outcomes. Overall, the risk to development outcomes is rated *modest*.

Monitoring & Evaluation

Design

3.19 Design of M&E of the macro framework was satisfactory because of its links to the PRGF. On the reform side, the (QAG) review panel of quality at entry summarized the weaknesses: "the operation does not incorporate adequate M&E arrangements, including baseline indicators and interim benchmarks. For that reason, it is unclear what is the causal chain or sequence of actions and performance that will lead to the desired, though not clearly articulated, outcomes or results of this operation." The rating for design is *modest*.

Implementation and utilization

3.20 The strengths and weaknesses of design carried over into implementation and utilization. As with ERSC, M&E of reforms tended to focus on output and compliance with output indicators. The rating for both elements and the overall rating for M&E is *modest*.

Bank Performance

3.21 Preparation for ESAC was technically stronger than for ERSC. Preparation and appraisal benefited from the availability of a new Investment Climate Assessment, and from a slightly more relaxed schedule. Nevertheless, as the QAG assessment emphasized (see paragraph 3.08 above), there were many design flaws. IEG concurs with the QAG rating of quality at entry – *moderately satisfactory*.

3.22 Supervision of the public sector management component of ESAC benefited from the relocation to Addis Ababa of a public sector specialist. There seems to have been little follow-up on the delay in effectiveness. The only project status report is dated

December 30, 2002, a month after effectiveness, and it does not appear to have been based on a mission. Supervision is rated *moderately satisfactory*.

3.23 The overall rating is *moderately satisfactory*.

Borrower Performance

3.24 The Government formally complied with most of the agreed prior actions in the policy matrix but frequently with shortcomings (such as in the case of the Public Investment Law) or with delays (as in the case with the approval for the MEFF) that undermined the spirit of the undertakings. The delay in effectiveness was due to delays by the Government. The delay may have been for a sound reason (less urgency in the need for balance of payments finance), but this is not entirely clear. The overall rating is *moderately satisfactory*.

4. FIRST POVERTY REDUCTION SUPPORT OPERATION (PRSC I)

Background

4.1 The SDPRP (Ethiopia's PRSP) was completed in 2002. The Joint Staff Assessment by the Bank and the Fund endorsed the SDPRP but had several suggestions for improvement: need for alternative macroeconomic scenarios; better agricultural and PSD strategies; an evaluation of early experience with decentralization; better costing of programs; and development of a strategy to manage and reduce vulnerability.

4.2 A new Bank CAS (March 2003) was aligned with the SDPRP. As noted in the Introduction, the CAS had three thematic objectives: enhancing pro-poor growth through supporting PSD and rural growth; enhancing human development by improving governance; and reducing vulnerability.

4.3 The main instrument for implementing CAS objectives was direct budget support through a program of PRSC operations. The PRSC program was to be a series of three single-tranche operations within a medium-term framework. Other donors would provide parallel budget support. Each PRSC operation would outline proposed actions and triggers for the next, with the amount varying between \$120 million to \$150 million depending on performance. The PRSC was complemented by a major capacity-building project (PSCAP), investment projects in other areas, and by a CFAA and CPAR to help improve financial management and accountability. Budget support through the PRSC would gradually replace SWAPs in health and education because these were viewed as ineffective in coordinating strategy and assistance in a decentralized system in which expenditure decisions were to be devolved to regions and woredas (districts). Direct budget support was expected to achieve three important goals: reduce transaction costs; ensure timely donor support; and ensure predictable federal transfers to encourage planning at lower levels. An unspoken objective of direct budget support was to permit "scaling up" of the level of assistance, an objective of the Africa Region for which PRSCs were seen as an important instrument.

4.4 PRSC I was approved on February 17, 2004, to support the 2003/04 budget, and PRSC II was approved on November 30, 2004, in support of the 2004/05 budget. The PRSC program was suspended after PRSC II because of governance concerns on the part of the Bank and other donors in the wake of the 2005 elections. PRSC III was replaced by a more limited Protection of Basic Services Project.

Objectives and Components

4.5 The objectives of PRSC I were to support implementation of the SDPRP by:

- Strengthening the focus on planning and budgeting processes including through the provision of a framework within which interested multi-sectoral program and budget support donors can participate.

- Stabilizing the public sector during a period of rapid state transformation in order to maintain pro-poor expenditures.
- Improving the investment climate (including for the rural sector).

4.6 The main sub-objectives and components of the operation were (see Annex D which gives the Policy Matrix):

❖ Public institutional performance

- Clarify the planning and budgeting cycle
- Improve public financial management
- Information technology and systems
- Devolution of procurement to federal budgetary institutions
- Legal framework for functional assignment in woredas and municipalities
- Support intergovernmental fiscal transition through capacity building
- Introduce results-oriented performance evaluation (ROPE)
- Introduce regional and ministerial pilots to improve performance management
- Improve M&E by issuing guidelines for release and access to data

❖ Rural development and vulnerability

- Improve agricultural research and focus of extension staff
- Enhance land tenure security
- Link grants for food security to reducing environmental and social risk

❖ Private sector development

- Steps to establish Competition Commission and Competition Secretariat
- Reduce cost and time of business registration
- Apply for accession to WTO
- Introduce restructuring plan for Commercial Bank of Ethiopia

❖ Human development

- Complete design and schedule for national learning assessment for two grades
- Develop design options for lower-cost school construction
- Adopt guidelines for health extension program
- Establish HIV/AIDS committee to pilot survey

4.7 Altogether there were 29 actions in the agreed policy matrix, of which 16 were prior actions. Nearly half of all actions (14 of 29) and of prior actions (7 of 16) were related to public institutional performance. The rural development objective accounted for 6 total and 5 prior actions; PSD for 5 total and 3 prior actions; and human development for 4 total and 1 prior action.

4.8 The Bank originally had even more ambitious objectives for PRSC I. In addition to the components included in PRSC I, the policy matrix flagged several additional issues to be addressed in PRSC II:

- Agricultural marketing (fertilizer policy reform)
- Privatization
- Urban land
- Telecommunications
- Education sector performance
- Health sector performance
- Nutrition

4.9 All of the rural development and PSD flagged items had been on the agenda of either ERSC or ESAC, and the Bank had hoped to be able to agree to further actions in most of these areas under PRSC I. Moreover, the Bank thought that the SDPRP had foreshadowed reforms in these areas, but it was not possible to reach agreement with the Government on the nature of specific actions. This was an example of the ‘inconsistent expectations’ found by OED in its review of Poverty Reduction Strategies¹² Because of disagreements, particularly over telecom sector reforms, the Bank reduced the amount of PRSC I from \$150 million to \$120 million.

Relevance of Objectives and Design

4.10 Project objectives were largely relevant. The objectives of the PRSC series were aligned with the SDPRP and were fully consistent with the CAS. Stabilization was no longer a pressing issue, but substantial medium-term resource transfer was needed, along with reforms and institutional development in a number of areas. The PRSC series was, as mentioned earlier, the main instrument of Bank strategy under the 2003 CAS.

4.11 Program design under the PRSC was also relevant in the sense that there was a link between project funding and key outputs such as budget support for social service delivery, and a link between time-bound actions (such as establishing budget timetables) and some outputs. But there were also shortcomings that made project design less relevant.

- The program started quickly, and although a great deal of analytical work was nearing completion and informed Bank proposals, policy dialogue with the Government had not always taken place or was at an early stage.¹³ This meant that the results matrix was weighted toward processes, studies, and action programs to be defined later.

¹² OED, 2004: “Review of the Poverty Reduction Strategy (PRS) Process: Ethiopia Case Study”, OED Working Paper.

¹³ The Africa Region has commented that the knowledge base for PRSC I did not depend solely on formal ESW products completed prior to the Board date. Parallel work on PSCAP preparation provided substantial knowledge on government systems, and a Strategic Partnership for Africa mission in which the Bank participated was a key input into many of the budget cycle related actions. The Investment Climate Assessment was available in time for preparation of the PRSC I PSD component and the last Public Expenditure Review in a long series focused on social expenditures and their effectiveness. Finally, several background studies underpinned a November 2002 rural sector workshop attended by the Prime Minister and key Cabinet members at which land tenure insecurity was discussed.

- The PRSC was large in relation to total lending and was meant to supplant rather than complement investment projects and SWAPs in sectors such as health and education. Putting so many of the eggs in one basket jeopardized Bank support if direct budget support were to be suspended (as it was during preparation of PRSC III) and also reduced opportunities for sector dialogue according to some country team sector specialists.
- The Bank had a two-front strategy to promote poverty reduction: (1) promoting pro-poor growth by improving the investment climate (including for rural development) and (2) improving delivery of social services. The PRSC program was meant to advance on both fronts, but though PRSCs were well-designed to fund social services, they proved to be a weak instrument for improving the investment climate or promoting private sector development in Ethiopia because of weak government commitment. Unfortunately, expanding social services without a foundation of growth is unsustainable.
- The Bank overestimated the commitment of the Government to private sector development so that little progress was made on fundamental issues of telecom reform, privatization, and land policy. The Bank recognized the Government's ambivalence, but chose to adopt PSD reforms as a "stretch" goal. It would have been better for the Bank to have been less ambitious on the PSD objectives and to have scaled back the size of the operation accordingly. (See Annex G for a more detailed account of constraints and changes in PSD.)

Relevance of objectives and design is rated *substantial*.

Achievement of Objectives (Efficacy)

4.12 It is difficult to map some objectives to components and actions in the policy matrix. The links are clear enough for the first objective: strengthening planning and budgeting processes. That objective is clearly linked to the public institutional performance sub-objective. Similarly, the objective of improving the investment climate (including for the rural sector) maps directly to the sub-objective on PSD and rural development and vulnerability. But the second objective – stabilizing the public sector during a period of rapid state transformation in order to maintain pro-poor expenditures – is problematic. The links to components are obscure. The objective seems to imply a concern with pro-poor budget allocations (as in ERSC and ESAC), but no condition or indicator is included in the operation. There is, however, an indicator for "increased resources focused on service delivery at regional level and below", which suggests that the objective is linked to the public institutional performance sub-objective. But then the human development component has no obvious link to any stated project objective. Because of this ambiguity, this report will treat human development as a sub-objective of objective number two and will rate all sub-objectives separately before also rating achievement of the objectives themselves.

Public institutional performance

4.13 The operation supported measures to improve planning and budgeting, financial management, and definition of intergovernmental fiscal relationships. This was the most important component of the operation as measured by number of actions taken. In

planning and budgeting the Bank and the Government sought to start afresh in an area which had few results under ERSC and ESAC. Prior actions (bolded in the annex tables) included: Cabinet approval of a 3-year Macro-Economic and Fiscal Framework (MEFF); issuance of a financial calendar and indicative planning figures for subsidies and grants to the regions; adoption of a new chart of accounts in four regions; issuance of a circular on devolution of procurement responsibilities; enabling legislation to assign expenditure and revenue responsibilities to municipalities in four regions and Addis Ababa; initiation of public sector delivery improvement policies (PSIP) in selected municipalities and ministries; and issuance of guidelines and standards for release of statistical data. These were mostly non-controversial first steps, but they were necessary for improvement over the longer term and were well-implemented. Implementation of other measures (not bolded in the annex tables) proved more challenging. Targets to reduce regional accounts backlogs and federal audits backlogs were only partly achieved or achieved after a delay. All federal institutions adopted a Results Oriented Performance Evaluation (ROPE) system, but the components for a meaningful evaluation are still not in place. In summary, the first operation made a strong beginning. The rating for this component is *substantial*.

Rural development and vulnerability

4.14 The main measures to be taken were in the areas of extension, fertilizer policy, land tenure security, and the environment. The Government agreed to increase the number of extension staff relieved of responsibility for delivering inputs. There was some increase in the number of such staff, but the number is unknown, and the target may not have been met. In an attempt to increase competitiveness and the role of the private sector in fertilizer marketing (and to reverse the failure of a previous fertilizer sector loan to achieve similar aims), the Bank requested the Government to reduce the amount of annual fertilizer sales with regional government guarantees to 200,000 tons. This target was not reached and the Government now argues that the target was unrealistic in view of a large increase in fertilizer demand. To promote land tenure security (all land is publicly owned), the Government agreed to issue Rural Land Proclamations and a directive to establish appropriate land administration institutions in four major regions. The proclamations were issued but only two communities in one region have reached the stage of issuing geo-referenced certificates with maps. On the environment, the Government agreed to issue a circular confirming that access to grants for food security will require compliance with guidelines for mitigating social and environmental risk and to secure Parliamentary approval of proclamations for environmental protection organs and environmental impact assessments. These actions were taken but the impact is unknown. The rating for the rural development and vulnerability sub-objective is *negligible*.

Private sector development

4.15 Telecom sector reform was meant to be the central feature of PSD support in this operation, but at the negotiations stage it became clear that no agreement was possible. No action on the telecom sector was included in the results matrix for PRSC I. The main accomplishments under the operation were submission of Ethiopia's application for accession to WTO; approval by MoFED of a restructuring plan for the main state-owned bank, and reduction in the cost of registering new businesses from \$425 to \$65 and the

time of registration from 44 days to 8 days. This last, rather dramatic, result was achieved by eliminating a requirement of a newspaper announcement. In the area of competition policy, critical because of the special privileges of state-owned and party-owned enterprises, the Government agreed to appoint members of a Competition Commission and to establish a Competition Secretariat. The Government failed to appoint private sector and civil society members of the Commission, however, and has not adequately staffed the Secretariat. The rating for the PSD sub-objective is *negligible*.

Human development

4.16 A major objective of this operation was to help stabilize the public sector during a period of rapid transformation in order to maintain pro-poor expenditure. Pro-poor spending (education, health, water, agriculture and natural resources, and roads) did increase between 2002/03 and 2005/06 by 28.8 percent in real terms per capita (compared to 22.8 percent for total public expenditure). Education spending grew particularly fast, roads less so, and real per capita health expenditure fell, but overall the operation achieved the resource transfer objective. Specific measures supported in the results matrix were to complete preparation of low-cost primary school building design options; adoption of guidelines defining a minimum package of services at the woreda level with associated staffing requirements; completing a design and implementation schedule for national learning assessments; and establishing a committee to facilitate piloting an HIV/AIDS survey. These were mostly achieved with some delay. The rating is *substantial*.

Objective 1: Strengthening the focus on planning and budgeting

4.17 Substantial progress was made in strengthening the focus on planning and budgeting processes, as indicated above. In addition to the improvements in the Government's planning and budgeting, donors were pleased with the improvements in donor coordination under the PRSC program. The rating is *substantial*.

Objective 2: Stabilizing the public sector to maintain pro-poor expenditures

4.18 Substantial progress was also made in stabilizing the public sector. The most important indicators are that both total and pro-poor public expenditure grew in real terms during and since the operation. Some progress was also made in addressing service delivery. The rating is *substantial*.

Objective 3: Improving the investment climate (including for the rural sector)

4.19 Negligible progress was made in improving the investment climate (including for the rural sector), for reasons given above. The rating is *negligible*.

4.20 Despite significant shortcomings in achievements of some objectives and sub-objectives, overall efficacy is rated *substantial*.

Outcome

4.21 PRSC I achieved satisfactory outcomes in strengthening planning and budgeting and in improving institutional performance, and in expanding budget support and improving governance of service delivery for human development. Outcomes were unsatisfactory for promoting private and financial sector development, and for rural development and vulnerability. The overall outcome rating is *moderately satisfactory*.

RISKS TO DEVELOPMENT OUTCOMES

4.22 The main risk to the outcome rating is that poor governance or renewed conflict could undermine progress in public expenditure/institutional performance and in service delivery. Systemic and institutional improvements in planning and budgeting have been greater at the central government level, partly because of lower capacity at lower levels of government. Politicization of decentralization could both provoke conflict and lead to loss of donor support. Furthermore, unless the investment climate (including prospects for rural development) improves, sustainable progress in human development will be difficult. The overall risk is rated *significant*.

Monitoring and Evaluation Design, Implementation, and Utilization

4.23 Considerable effort was made to devise monitorable indicators of outputs and outcomes of the SDPRP. M&E was handicapped by lack of good baseline data. More could have been done to define outcome indicators for public institutional performance and governance, as well as specific elements of the investment climate (competition, efficiency, risk). Too many of the indicators measure “outputs” or “actions taken”. The PRSC program and the associated PSCAP supported the introduction of systems and technology to collect and improve the timeliness of expenditure reporting and of education and health indicators, but data and indicators from lower levels were not always reported. Overall there was only modest progress in developing M&E from a poor base. The overall rating for M&E is *modest*.

Bank Performance

4.24 Quality at entry of PRSC I was only moderately satisfactory for the reasons given in the above discussion on relevance of objectives. Reducing credit size in response to unsatisfactory performance was the right thing to do, and was fully in line with the rationale that budget support operations should use an “up-down switch” rather than the “on-off switch” of structural adjustment loans, but this could not overcome the disadvantages of overestimating the Government’s commitment to private sector development and rural development.

4.25 Supervision was conducted mainly informally or in the context of pre-appraisal and appraisal of PRSC II. An important innovation of PRSC I was the introduction of a Joint Budget and Aid Review (JBAR) to discuss budget coordination and policy issues between the Government and donors. This is viewed by both the Government and most donors as an improvement over the PERs that the JBAR replaced. Both the Government

and donor partners criticized the Bank for not putting the task team leader of such an important program in the field. Quality of supervision is rated satisfactory.

4.26 Overall rating of Bank performance is *satisfactory*.

Borrower Performance

4.27 Borrower performance was primarily determined by the commitment, or lack thereof, to particular objectives or approaches. Where commitment was high – public expenditure and institutional performance, and human development – performance was satisfactory. Where commitment was low or the Government’s approach was at odds with that of the Bank, as in private sector development and rural development, performance was unsatisfactory. Performance was also affected by capacity. Federal agencies generally performed better than those at lower levels. Overall Borrower performance is rated *moderately satisfactory*.

5. SECOND POVERTY REDUCTION SUPPORT OPERATION (PRSC II)

Background

5.1 Preparation of PRSC II followed on immediately after disbursement of PRSC I. The schedule was, in fact, advanced to align better with the Ethiopian budget cycle to enable disbursement to take place earlier in the fiscal year. PRSC I was approved February 17, 2004, and was effective on March 23, 2004. Pre-appraisal of PRSC II took place in May, 2004, appraisal in September/October, and Board approval was November 20, 2004.

5.2 PRSC II was intended to continue and deepen reforms in all the areas covered by PRSC I, but with greater emphasis on PSD and rural development. Progress in these two areas was limited, however, and once again the size of the operation was cut from an originally scheduled amount of \$150 million to \$130 million. According to the PRSC II Program Document (Number 29772-ET, November 1, 2004, p. 29), “actions to foster rural growth have not been as fast as expected, and the telecom action plan – which PRSC I envisaged as a prior action for the operation – is inadequate: it is comprehensive and technically detailed, but there is no financing plan or policy moves to help sustain the very ambitious goals, nor are there policies planned to attract larger financing from the private sector”. The document goes on to say: “In view of this evaluation, the PRSC II amount proposed is US\$130 million. The allocation also intends to signal in strong terms the World Bank’s assessment that the telecom strategy, as expressed in the Letter of Communication Policy, is inadequate.”

5.3 Like PRSC I, PRSC II identified actions for the next planned operation (PRSC III) in the policy matrix (see Annex E). But PRSC III did not take place. Elections in May 2005 were disputed and were followed by demonstrations, arrests of journalists and opposition leaders, and prolonged civil unrest. After student demonstrators were killed in November 2005, the Bank and other development partners suspended direct budget support for Ethiopia even though preparations for PRSC III were well-advanced. In the following months, the Bank decided to replace PRSC III with a project for Protection of Basic Services (PBS). Some other donors also supported PBS. Although classified as an investment project rather than a development policy operation, PBS in effect provided budget funds for social sectors, and could be viewed either as a multi-sector SWAp or as partial budget support.

Objectives and Components

5.4 The objectives of PRSC II were to continue to support the Government’s medium-term reform program to secure improvements in:

- The investment climate.
- Governance and service delivery.
- Vulnerability.

5.5 The sub-objectives of PRSC II were the same as those of PRSC I. Components included all of those in the previous operation and more, although some of the new components had been flagged in the PRSC I policy matrix, together with many of the policy actions. The main sub-objectives and components were:

❖ ***Public Institutional Performance***

- Improve the planning and budgeting cycle
- Implement Sector Wide Approach for PSCAP
- Improve public financial management by reducing audit and accounts backlog
- Roll out software for information technology system
- Progress on Procurement Proclamation
- Improve legal framework for functional assignment in woredas and municipalities
- Issue fiscal decentralization strategy
- Federal agencies and four regions adopt ROPE system
- Improve performance management
- Implement M&E plan

❖ ***Rural Development and Vulnerability***

- Reduce the role of government in input delivery and credit administration
- Agree on terms of reference for fertilizer marketing study
- Extend land tenure security measures to another region
- Define and start implementing productive safety nets to reduce vulnerability
- Create coordination structure to develop nutrition strategy
- Issue various environmental guidelines

❖ ***Private Sector Development***

- Appoint members of Competition Commission and create Secretariat
- Review commercial registration and licensing regulations
- Take further steps toward WTO accession
- Finalize Privatization Action Plan and begin implementing agreed measures
- Adopt revised urban land lease and other measures in Addis Ababa
- Review micro and rural finance strategy
- Implement CBE restructuring plan in banking sector
- Adopt revised telecommunications policy allowing partial liberalization

❖ ***Human Development***

- Achieve satisfactory progress in education sector review
- Analyze data from national learning assessment
- Adopt design options and guidelines for low-cost school construction
- Achieve satisfactory progress in health sector review
- Implement plan to train health extension workers
- Develop a reproductive health strategy
- Start HIV/AIDS biological survey
- Start to develop National Action Plan on Gender

5.6 There were far more actions in the policy matrix than under PRSC I (53 vs. 29), but fewer prior actions (10 vs. 16). By sub-objective the numbers of total actions (prior actions) were:

- Public institutional performance: 17 (4)
- Rural development and vulnerability: 12 (1)
- PSD: 15 (4)
- Human development: 9 (1)

Relevance of Objectives and Design

5.7 Some of the same comments on PRSC I are applicable to PRSC II. Project objectives were relevant in the sense that they were aligned with SDPRP and were consistent with the CAS. The objectives and components also dealt with important issues, but with the experience accumulated under the three preceding operations (PRSC I, ESAC, and ERSC), it might have been wise to have re-examined whether direct budget support was the best instrument for pursuing some of these objectives. The PRSC I Program Document (Number 27644-ET, January 20, 2004, p. 24) had noted that technical assistance missions had been fielded in several areas and that “these missions have provided the primary vehicle for re-engaging with the Government on areas where the overall policy dialogue had reached a standstill (e.g. in the financial sector or telecommunications reform). These missions have allowed the areas of re-engagement to be identified *without any expectations regarding follow-on activities.*” [emphasis added] With the additional experience of the telecom sector during appraisal, a more drastic cut in the scope and amount of PRSC II (or, at the very least, of PRSC III) should have been considered. Stretched goals may sometimes be appropriate, but not after repeated setbacks. They are perhaps better suited to floating-tranche structural adjustment operations than to direct budget support.

5.8 Project design was better in one respect than PRSC I. There was more analytical work available and more time to discuss previous work with the Government. But the additional policy dialogue did not lead to a scaling back of the operation. Rather, the project became even broader than the previous operation, with many more actions in many more areas. It was commonly observed, too (for example in a QAG program review), that project conditions for PRSC II were weak. Overall, the objectives and design of PRSC II failed to respond to changing circumstances and were less relevant than PRSC I. Relevance of PRSC II objectives and design is rated *modest*.

Achievement of Objectives (Efficacy)

5.9 The links between objectives and sub-objectives were much clearer and more straightforward than under PRSC I. Since much of the program is defined by the components, separate ratings are again given for each sub-objective and each objective.

5.10 By definition, prior actions were completed (or substantially completed) before effectiveness, but many of the steps taken were procedural and not always clearly linked to the desired outcomes. Actions supported in one operation often depended for success on further definition and implementation under subsequent operations – including under PRSC III which did not take place.

Public Institutional Performance

5.11 Improving public institutional performance was a sub-objective of governance and service delivery. Most measures to improve public sector institutional performance were meant to advance initiatives begun under PRSC I. Measures to extend the chart of accounts to more regions, reduce regional account backlogs, improve information technology and systems, enact a procurement strategy, and issue a fiscal strategy and a decentralization strategy were all achieved. In other areas there has been less progress. The Government agreed to revise the Financial Calendar and issue a directive on strategic planning consistent with MEFF, PIP/PEP, and the annual budgeting cycle. The Financial Calendar was issued, though there are still some coordination problems between the federal budget and transfers to lower levels. The directive, though much needed, has still not been produced and implemented. Audit backlogs for federal accounts were to have been reduced to one year. Some progress has been made but the backlog as of February 2007 was two years. A planned remuneration policy for federal and regional levels has fallen short of expectations. It is less a policy than a salary scale, which so far has only been adopted at the central government level. In general, more was attempted under this operation, but implementation slowed as complexities increased. The overall rating is *substantial*.

Rural Development and Vulnerability

5.12 PRSC II continued and extended measures begun in the previous operation in the areas of extension, fertilizer policy, land tenure, and the environment. In addition, this operation supported measures to reduce vulnerability. The targets for the percentage of extension staff free of responsibility for delivering inputs was raised to 85 percent and the target for government-guaranteed fertilizer sales was reduced to 100,000 tons. Once again, neither target was met. The Government also agreed to conduct a study of options for reforming the market structure for fertilizer imports and distribution. The study was completed. On land tenure, the Government agreed to review and harmonize Regional Land Proclamations and to identify best practices. This has been partially achieved. In the environmental area, the Government agreed to establish guidelines for selected sector environmental programs, social impact assessments, and resettlement; to establish regional environmental protection units, and to conduct a national workshop on implementation of the guidelines. All of these measures were completed. To try to reduce vulnerability, the Government agreed to define institutional arrangements, implementation modalities, and a monitoring mechanism for a system of multi-annual productive safety nets. The institutional structure has been set up and a manual for M&E has been prepared. As noted in paragraph 5.2, the Bank reduced the amount of PRSC II partly because of limited progress on rural development. Overall progress on rural development and vulnerability is rated *negligible to modest*.

Private Sector Development

5.13 The primary objective of this operation was intended to be private and financial sector development, but in the event little progress was made in some of the most critical areas. An agreed prior action to adopt a revised telecom sector policy allowing for partial liberalization of the sector was not satisfactorily achieved. The Government finalized a Privatization Action Plan and began implementing it. Though this improved procedures and made it possible to revive sales of public enterprises, privatization remains largely limited to small and medium enterprises.

Key sectors of the economy remain monopolized or dominated by state-owned enterprises and the net number of state enterprises continues to expand. The results matrix repeated the measures on competition policy that were not delivered under PRSC I, but these were again not achieved. Some progress was made in revising urban land leasing policy, but access to land remains one of the main constraints on PSD. A Memorandum of Foreign Trade Regime was submitted to WTO after a major delay (four years after the application for accession and two years after the date agreed as a prior action for this operation). Negotiations for membership still have to take place, but if Ethiopia becomes a member this will be significant because it commits the Government to introduce additional reforms such as opening up the financial sector to foreign participation after a specified time. The only unambiguous achievement under the results matrix was the review of strategy and the development of an action plan to improve access to micro and rural finance. The rating for the PSD sub-objective is *negligible*.

Human Development

5.14 Human development is a sub-objective of the PRSC II objective to improve governance and service delivery. Several specific measures were supported and fully achieved (sometimes with a delay): satisfactory implementation progress under the 2004 education sector review; commencement of a survey of education inputs and achievement results; initiation of an HIV/AIDS survey; completion of the national learning assessment and development of recommendations; development of a reproductive health survey; and initiation of a national action plan on gender. Other measures supported but only partly achieved were: development and adoption by all regions of guidelines for lower-cost school construction; implementation of a health extension package including training of workers; completion of a health worker study with follow-up implementation of recommendations; and establishment of a multi-sector coordination structure for nutrition and development of a nutrition strategy. The overall rating for this component is *substantial*.

Objective 1: The Investment Climate

5.15 *Negligible* progress was made in improving the investment climate, for reasons given above in the discussion of the private sector development sub-objective.

Objective 2: Governance and Service Delivery

5.16 Progress in governance and service delivery was mixed. Governance in this context mainly referred to budget and financial management, and in these areas progress was substantial. Service delivery outcome indicators improved with respect to health and education enrollment, but education quality deteriorated. Overall, progress was *modest*

Objective 3: Vulnerability

5.17 The Bank program as a whole has made substantial progress in addressing the severe problem of vulnerability, mainly through the Productive Safety Net Program (PSNP) which is funded separately. Establishment of the PSNP was a prior action under PRSC II. Achievement of the broader rural development component under the vulnerability objective was negligible to modest, as detailed above. The overall rating is *modest*.

5.18 Overall efficacy is rated *modest*.

Outcome

5.19 The relevance of objectives and design of PRSC II was less than under PRSC I. Insufficient account was taken of the lack of progress on private sector development and policy actions were relatively unambitious. Achievement of objectives (efficacy) was also less than under PRSC I. Negligible progress was made in improving the investment climate. In governance and service delivery, progress on the public institutional performance component slowed and the human development component was mixed, yielding an overall rating of modest. The vulnerability objective, encompassing the rural development and vulnerability component, is also rated modest. The overall outcome rating is *moderately unsatisfactory*.

RISKS TO DEVELOPMENT OUTCOMES

5.20 All the risks outlined for PRSC I remain important: risks of renewed conflict, weak capacity, politicization of decentralization, and the failure to improve the investment climate for PSD and rural development. The PAD identified some of these and a number of other more specific risks (p. 2): “the one-off transitional costs of devolving to local woreda administrations, implementing the private and financial sector reform agenda and building private sector capacity, developing and retaining skilled workers in the absence of a viable public sector salaries/wage policy, weak enforcement of guidelines for resettlement/access to new land program, continued reporting lags in actual expenditures at primary service levels, congestion effects of several programs involving local service cadres (e.g. health extension workers, teachers, agriculture extension agents), and the absence of demand-side pressures from civil society and citizens.” Taken together, this is a worrying list of concerns about the capacity and willingness of the Ethiopian Government to carry out the PRSC program.

5.21 The overall risk to development outcomes is rated *significant*.

Monitoring and Evaluation Design, Implementation, and Utilization

5.22 Little additional progress on M&E design was achieved under PRSC II. Most design elements had been put in place under PRSC I and remained unchanged. The Results Matrix (see Annex F) includes some outcome measures with plausible links to PRSC actions, but it also includes others (such as agricultural growth) for which the links with PRSC actions is tenuous. Definitions of indicators including baseline values and medium-term targets need to be strengthened. Implementation and utilization continued to be hindered by lack of reporting from lower levels.

5.23 The overall rating is *modest*.

Bank Performance

5.24 Quality at entry was moderately satisfactory. As discussed above under relevance of objectives and design, the decision to cut the size of the operation because of lack of progress on the rural and PSD agenda was commendable as far as it went, but there was

an increasing case for more fundamental rethinking of the design and size of the PRSC program. The risks cited by the Region (see above) reinforce the view that the program risked being ineffective because of problems of capacity and willingness to take actions in some important areas.

5.25 There was no formal supervision, but the JBAR process put in place for the PRSC program seems to have been fairly successful in focusing attention on key implementation issues, though not always successful in getting action (e.g. reporting from lower levels remained inadequate). The Government and most donors felt the JBAR was much more useful and relevant than the annual PER series it replaced. Quality of supervision was satisfactory.

5.26 The overall rating of Bank performance is *moderately satisfactory*.

Borrower Performance

5.27 As under PRSC I, borrower performance was highly variable. Where commitment was high, performance was satisfactory. In areas where the Government disagreed with the Bank, performance was unsatisfactory. Capacity also affected performance with higher levels of performance at the central government level. The overall rating of Borrower performance is *moderately satisfactory*.

6. OVERALL PRSC PROGRAM

6.1 This section attempts a brief summary evaluation of the PRSC program as a whole by examining a different and somewhat broader set of questions than in previous sections. What were the strengths and weaknesses of the PRSC program – what worked, what did not, and why? Was direct budget support the right instrument (or was it used in the right combination with other instruments) to achieve particular objectives? Did the PRSC program avoid the most common pitfalls of direct budget support: undermining export performance through “Dutch disease”; undermining tax effort; failing to reach intended targets because of budget fungibility; and weakening commitment to reform and development?

What Worked and What Didn't

6.2 The overall objectives of the PRSC were very ambitious. The CAS in 2003 listed the PRSC as a major instrument in achieving every single objective of the country assistance strategy: enhancing pro-poor growth (through PSD and rural growth); reaching the MDGs (by improving human development and improving governance); and reducing vulnerability. The objectives and main components of the PRSC program were to improve: public institutional performance; rural development and vulnerability; private sector development; and human development. Additional benefits expected from direct budget support through PRSC were: better coordination among donors; better alignment of aid with Government objectives and the Ethiopian budget cycle; reduced transactions costs; and improved medium-term planning because of greater predictability of support. Although rarely mentioned as an objective, many also expected direct budget support to enable aid to be scaled up.

6.3 *Process objectives.* Until it was suspended, the PRSC program in Ethiopia did help achieve many of the process objectives of coordination, alignment, and predictability. Most development partners reported that coordination improved under PRSC and their complementary programs of budget support. Development partners who did not provide budget support were also included in discussions and generally felt that coordination improved. Replacement of annual public expenditure reviews with more frequent and less formal JBAR discussions was seen as a distinct improvement, though some development partners noted that dialogue with the Government was still focused largely on budget allocation rather than on the broader agenda of growth and policy reform. The PRSC program reduced transaction costs for the Government, but not necessarily for development partners because of the elaborate coordination mechanisms which were set up. The Government reported that the PRSC improved predictability of aid flows, thereby enabling a better balance between capital and recurrent expenditure. Coordination within the Government was also said to have improved in response to the need to implement agreed actions in the policy matrix and to participate in JBAR discussions. But transparency and accountability for spending was weak. In particular, it was never possible to track expenditures at the woreda level. Correcting this became an important objective of the PBS project that replaced PRSC II after suspension of the program.

6.4 Progress on specific objectives and components of the PRSC program was variable. Broadly speaking, progress on public institutional performance and human development was moderately satisfactory, but little was achieved on rural development and private sector development.

6.5 **Public institutional performance.** Over the course of the two PRSC operations the planning and budgeting framework improved, but directives on integration of different budgets remain to be worked out. The fiscal decentralization strategy is a good start, but leaves unresolved important issues related to the distribution of responsibilities among different levels of government, determination of resources to be transferred downward, or own resources for woredas. Resources for regions were expanded rapidly but so were expenditure responsibilities.

6.6 **Rural development and vulnerability.** Fertilizer policy and land tenure security are both critical issues for rural development, but the Ethiopia CAE (2008) found that little overall progress has been made on these issues, mainly because of government reluctance to encourage private sector participation in marketing or to reduce government control of land. Unlike fertilizer and land policy, the Bank and the Government are in broad agreement on the strategy to protect the vulnerable and in this area there has been progress. There is also broad agreement on the environment. Various environmental agencies have been established and guidelines issued as agreed, but environmental protection agencies are generally regarded as weak and the Bank has been criticized by other development partners for neglecting to follow through in its supervision of environmental issues.

6.7 **Private sector development.** Despite modest improvements in privatization, the financial sector, business regulation, and access to land, there was no or little progress on the key issues of telecom sector reform or competition policy. The share of private investment in GDP showed no trend between 2001/02 and 2005/06 (see Table 2). For a more detailed discussion of the investment climate and private sector development, see Annex G. Overall, the improvement in the investment climate has not yet helped to resolve the most binding constraints facing the private sector, including barriers to entry.

6.8 **Human development.** Overall, substantial progress was made, particularly in education, on funding service delivery and developing data, processes, and institutions. Health fared less well and education quality remains poor, though enrollment and completion rates have increased. Under the program some progress was made in addressing issues of education quality, reproductive health, and gender.

Choice of Instrument

6.9 Was PRSC the right instrument, or was it properly coordinated with other instruments, to achieve particular objectives?

6.10 The PRSC was appropriate for promoting better institutional performance, for two reasons. First, public expenditure management was directly related to budget support, so there was a strong focus on this component and strong incentive for progress. Second, capacity building under the PSCAP program complemented the PRSC. PSCAP provided

not only needed training and facilities but also essential information on operational strengths and weaknesses. Improvements in institutional performance may be more attributable to PSCAP than to PRSC, but the two programs working together achieved more than either working alone.

6.11 It seemed reasonable to expect that PRSC would also be appropriate for supporting human development. Increasing pro-poor expenditure had been an objective of previous operations, and in the health and education sectors, SWAs had been operating but were becoming less relevant as social expenditure decisions were being decentralized. Budget support through PRSC was expected to replace all project and sector lending in health and education in Ethiopia. This could be premature. The emerging problems in the social sectors in Ethiopia were not quantity but quality (in education), and not expanding facilities but making use of existing facilities (in health). A background paper for the Ethiopia CAE¹⁴ concluded that, in education, ‘the choice of the PRSC instrument as the sole provider of assistance does not seem to sufficiently adjust Bank assistance for targeting quality issue.’ While ESDP [the education SWA] offered leverage to pursue a quality focus in sector dialogue and building capacity in the implementing institutions, the PRSC by its nature and motivation was much less likely to deliver on these counts, particularly on regional level. It was, however, potentially well suited to pursue quality issues through policy advances and adjustments on federal level. In combination the two types of project might have complemented each other. In health, the closing date of the existing HSDP was extended because of disbursement delays and so continued in parallel with the PRSC, but the HSDP itself failed to come to grips with underutilization of facilities in the health sector¹⁵ -- nor was the PRSC effectively used to advance the dialogue on health policy.

6.12 In rural development, the Bank tried to use the PRSC to promote change in fertilizer policy, and to a lesser extent, land policy, without much success in either case. According to sector staff, one reason for the lack of success was that the Bank had no investment projects through which it could keep in touch with what was happening on the ground. Again, there was too much reliance on the PRSC and too little use of complementary projects. But the PRSC was used to facilitate the introduction of the Productive Safety Nets Project through a prior action under PRSC II.

6.13 The PRSC also was of limited use in promoting PSD. This was not due to lack of complementary projects – there is an ongoing Private Sector Capacity Building project – but rather to lack of agreement on major policy issues. It is unlikely that any lending instrument could have been effective under such conditions. Because of limited success in promoting PSD through PRSC and other lending instruments, the Bank has increasingly shifted to a more indirect approach to promoting dialogue and policy change through analytic and advisory activities (AAA). On issues such as telecom policy, the government and the Bank have agreed to disagree, though they still discuss sector issues. The Bank’s strategy is to seek entry points for PSD dialogue by addressing specific concerns of the government, such as export promotion.

¹⁴ Svenja Weber-Venghaus, Bank Assistance to Education, Health and Gender in Ethiopia)

¹⁵ IEG recently rated the project outcome Moderately Unsatisfactory

Avoiding Pitfalls of Direct Budget Support

6.14 There are a number of common concerns about the possible adverse macroeconomic or incentive effects of budget support. These include effects on export competitiveness (Dutch disease), tax effort, expenditure diversion, and commitment to reform. In Ethiopia the effects seem to have been mixed.

6.15 The effect of foreign finance on export competitiveness depends mainly on how it is used. If used to fund non-traded goods, foreign finance can lead to an appreciation of the exchange rate and a decline in export competitiveness. In principle direct budget support is no different from any other form of aid in this respect, but the danger is that a higher share will be used for expenditure on government salaries and other non-traded goods. Analysis of potential Dutch disease generally requires a detailed econometric study. One encouraging indicator is that the export/GDP ratio rose from 12.6 percent in 2001/02 to 15.8 percent in 2005/06 (see Table 2), with a substantial contribution coming from non-traditional exports. But there is a danger that increased financing of recurrent expenditure could undermine export competitiveness and growth. This is an issue that requires further study and close monitoring.

6.16 The evidence on tax effort is less encouraging. The SDPRP aimed to raise the revenue/GDP ratio by about one percentage point per year. It is difficult to arrive at an assessment on this because of data deficiencies. Based on official data, there has been no discernible trend between 2001/02 and 2005/06 (see Table 2). On the other hand, if GDP growth has been overestimated as many observers believe, the revenue/GDP ratio would have risen (since revenue estimates are more reliable).

6.17 Fungibility of resources always provides scope for intended increases in resources for particular purposes. There is little evidence that this has happened in Ethiopia at the broad level of pro-poor vs. other spending, but within categories there is a concern that too much spending has gone toward setting up administrative infrastructure under decentralization, that there may be an imbalance between different categories of spending (for example in the health sector), and that money at the local level may be diverted from development to political purposes. The real problem is that the expenditure tracking system was inadequate to monitor the extent to which budget support under PRSC was used for its intended purpose.

6.18 There is little evidence that budget support through the PRSC program has weakened Government commitment to reform. But it became evident early in the program that the Bank had overestimated the initial commitment of the Government to PSD. Under PRSC I the Bank took appropriate action by cutting the size of the operation by 20 percent. When disagreements continued, the Bank cut PRSC II as well, but only by 13.3 percent. At that point the program should have been cut much more sharply to reflect poor prospects for progress in PSD and rural development.

Summary Findings and Rating

6.19 The main findings are that, while the PRSC instrument was a useful instrument in some areas, in Ethiopia there was too much budget support too soon.

- The Bank moved too quickly into direct budget support through the PRSC program. Direct budget support for human development was premature. Despite considerable ESW on PSD, not enough policy dialogue had taken place to develop a shared understanding and compatible expectations between the Bank and the government.
- The Bank also relied too heavily on direct budget support (too much as well as too soon). Heavy reliance on this instrument increased the risk of program failure and led to programs that were too broad and ill-focused to be effective in promoting policy change and institutional development as opposed to resource transfer.
- The complementary PSCAP program increased the effectiveness of the PRSC in public expenditure management. Effectiveness in rural development and education suffered because of the lack of complementary projects and programs.
- The main macro and motivational pitfalls of direct budget support were avoided in the PRSC program.
- The PRSC improved coordination and alignment, but it proved no more flexible than other forms of aid. The program was cut, but not enough, when it turned out that Government support for PSD and rural development was weak. When a major dispute on governance arose, the entire program was terminated.

6.20 The outcome rating for the entire PRSC program is *moderately unsatisfactory*.

Lessons

- Budget support and other program assistance needs to be undertaken within a medium-term policy framework. This was one of the main lessons learned as a result of the first two operations under review, and it was applied to the design of the PRSC program.
- Complementary investment or capacity-building projects may be critical to the effectiveness of direct budget support through a PRSC. Complementary capacity-building under PSCAP were important for the progress made in strengthening public institutional performance under the PRSC program. The absence of complementary investment projects in agriculture limited the effectiveness of PRSC in rural development because of the lack of information on the part of the Bank on activities close to the ground.
- Successful programmatic budget support through PRSCs requires careful preparation. Prior analytical work and policy dialogue are needed to prevent misunderstandings and inconsistent expectations, like those that arose for the private sector development program under PRSC I.
- Direct budget support is high-risk. It is vulnerable to sudden loss of political support from bilateral donors and is no less subject to sudden termination than policy-based lending.

Annex A: Basic Data Sheet

ETHIOPIA ECONOMIC REHABILITATION SUPPORT CREDIT (CREDIT: C3512-ET)

Key Project Data (amounts in US\$ million)

	<i>Appraisal estimate</i>	<i>Actual or current estimate</i>	<i>Actual as % of appraisal estimate</i>
Total project costs	150	150	100
Loan amount	150	150	100
Cofinancing			
Cancellation			
Institutional performance			

Project Dates

	<i>Original</i>	<i>Actual</i>
Initiating memorandum		01/18/2001
Negotiations		06/05/2001
Board approval		06/05/2001
Signing		06/19/2001
Effectiveness		07/05/2001
Closing date		06/30/2002

Staff Inputs (staff weeks)

<i>Stage of Project Cycle</i>	<i>Actual/Latest Estimate</i>	<i>Stage of Project Cycle</i>
	<i>No. Staff weeks</i>	<i>US\$ ('000)</i>
Identification/Preparation	65*	374*
Appraisal	n/a	n/a
Negotiations	n/a	n/a
Supervision	n/a	n/a
Other	5	16
Total	70	390

*These figures reflect the total time and cost of the project.

Mission Data

	<i>Date (month/ year)</i>	<i>No. of persons</i>	<i>Specializations represented</i>	<i>Performance rating</i>	
				<i>Implementation Progress</i>	<i>Development Objective</i>
Identification/ Preparation	01/01	1	Team Leader		
		2	Public Sector Specialist		
		2	Lead Economist		
		1	Sector Manager		
		1	Economist		
		1	Research Analyst		
		2	Agricultural Economist		
		1	Financial Management Specialist		
		3	Consultant		
Appraisal/ Negotiation	N/A				
Supervision	10/01	1	Team Leader		
		2	Public Sector Specialist		
		1	Public Expenditure Specialist		
Completion	07/03	1	Team Leader		
		1	Public Sector Specialist		
		1	Economist		
		1	Research Assistant		
		3	Consultant		

Other Project Data

Borrower/Executing Agency:

FOLLOW-ON OPERATIONS

<i>Operation</i>	<i>Credit no.</i>	<i>Amount (US\$ million)</i>	<i>Board date</i>

ECONOMIC STRUCTURAL ADJUSTMENT CREDIT (CREDIT C3666)

Key Project Data (amounts in US\$ million)

	<i>Appraisal estimate</i>	<i>Actual or current estimate</i>	<i>Actual as % of appraisal estimate</i>
Total project costs	120	120	100
Loan amount	120	120	100
Cofinancing			
Cancellation			
Institutional performance			

Project Dates

	<i>Original</i>	<i>Actual</i>
Initiating memorandum		02/12/2001
Negotiations		02/19/2002
Board approval		06/18/2002
Signing		06/27/2002
Effectiveness		11/28/2002
Closing date		06/30/2004

Staff Inputs (staff weeks)

<i>Stage of Project Cycle</i>	<i>Actual/Latest Estimate</i>	<i>Stage of Project Cycle</i>
	<i>No. Staff weeks</i>	<i>US\$ ('000)</i>
Identification/Preparation	38*	374*
Appraisal/Negotiations		
Supervision		
Other	5	16
Total	43	330

*These figures reflect the total time and cost of the project.

Mission Data

	<i>Date (month/ year)</i>	<i>No. of persons</i>	<i>Specializations represented</i>	<i>Performance rating</i>	
				<i>Implementati on Progress</i>	<i>Development Objective</i>
Identification/ Preparation	12/01	1	Team Leader		
		3	Public Sector Specialist		
		1	Telecommunications Specialist		
		1	Land Specialist		
		2	Economists		
		1	Communications Specialist		
		1	Research Analyst		
Appraisal/ Negotiation	03/02	1	Team Leader		
		1	Public Sector Specialist		
		1	Public Expenditure Specialist		
		1	Telecommunications Specialist		
		2	Economists		
		3	Consultant		
Supervision	n/a				
Completion	07/03	1	Team Leader		
		1	Public Sector Specialist		
		1	Economist		
		1	Research Assistant		
		3	Consultant		

Other Project Data

Borrower/Executing Agency:

FOLLOW-ON OPERATIONS

<i>Operation</i>	<i>Credit no.</i>	<i>Amount (US\$ million)</i>	<i>Board date</i>

FIRST POVERTY REDUCTION SUPPORT (LOAN/CREDIT H0730)

Key Project Data (amounts in US\$ million)

	<i>Appraisal estimate</i>	<i>Actual or current estimate</i>	<i>Actual as % of appraisal estimate</i>
Total project costs	150	150	100
Loan amount	120	120	100
Cofinancing			
Cancellation			
Institutional performance			

Project Dates

	<i>Original</i>	<i>Actual</i>
Concept Review:	07/31/2003	
Appraisal:	10/23/2003	
Approval:	02/17/2004	
Effectiveness:	03/23/2004	03/23/2004
Closing:	12/31/2004	12/31/2004

Staff Inputs (staff weeks)

<i>Stage of Project Cycle</i>	<i>Actual/Latest Estimate</i>	<i>Stage of Project Cycle</i>
	<i>No. Staff weeks</i>	<i>US\$ ('000)</i>
Identification/Preparation	65*	374*
Appraisal	n/a	n/a
Negotiations	n/a	n/a
Supervision	n/a	n/a
Other	5	16
Total	70	390

*these figures reflect the total time and cost of the project.

Other Project Data

Borrower/Executing Agency:

FOLLOW-ON OPERATIONS

<i>Operation</i>	<i>Credit no.</i>	<i>Amount (US\$ million)</i>	<i>Board date</i>

POVERTY REDUCTION SUPPORT CREDIT 2 DPL - FY05 (LOAN: JPN 51119, IDA H1350, JPN 5380)

Key Project Data (amounts in US\$ million)

	<i>Appraisal estimate</i>	<i>Actual or current estimate</i>	<i>Actual as % of appraisal estimate</i>
Total project costs	150	150	100
Loan amount	130	130	100
Cofinancing			
Cancellation			
Institutional performance			

Project Dates

	<i>Original</i>	<i>Actual</i>
Concept Review:		04/27/2004
Appraisal:		09/21/2004
Approval:		11/30/2004
Effectiveness:		12/23/2004 (A)
Closing:		12/31/2005

Staff Inputs (staff weeks)

<i>Stage of Project Cycle</i>	<i>Actual/Latest Estimate</i>	<i>Stage of Project Cycle</i>
	<i>No. Staff weeks</i>	<i>US\$ ('000)</i>
Identification/Preparation	65*	374*
Appraisal	n/a	n/a
Negotiations	n/a	n/a
Supervision	n/a	n/a
Other	5	16
Total	70	390

*These figures reflect the total time and cost of the project.

Other Project Data

Borrower/Executing Agency:

FOLLOW-ON OPERATIONS

<i>Operation</i>	<i>Credit no.</i>	<i>Amount (US\$ million)</i>	<i>Board date</i>

Annex B: Ethiopia Economic Rehabilitation Support Credit - Policy Reform Matrix

(P072890; Credit: C3512) Government's Policy Objectives and Implementation Benchmarks

Development Objectives/Issues	ERSC		Benchmarks		Outcomes
	Actions before Board Presentation	Macroeconomic stability, growth and poverty reduction	Actions before end 2001/02	Actions before end 2002/03	
<p>Focus on Poverty Alleviation & Growth.</p> <ul style="list-style-type: none"> • Over 45% of population or 28 million is poor; 24% of population live in abject poverty. 	<ul style="list-style-type: none"> • Prepare I-PRSP (Interim Poverty Reduction Strategy Paper). 	<ul style="list-style-type: none"> • Prepare full PRSP 	<ul style="list-style-type: none"> • Prepare progress report on PRSP 	<ul style="list-style-type: none"> • Articulated and budget costed strategy for poverty reduction. 	
<p>Recover of economic growth and maintain macroeconomic stability.</p> <ul style="list-style-type: none"> • Worsening of economic situation in FY00 (sharp deterioration of terms of trade, a severe drought and the conflict with Eritrea) • A Peace Agreement with Eritrea was signed on December 12, 2000. 	<ul style="list-style-type: none"> • Agreed macroeconomic framework. 	<ul style="list-style-type: none"> • Satisfactory performance under agreed macroeconomic framework. 	<ul style="list-style-type: none"> • Satisfactory performance under agreed macroeconomic framework. 	<ul style="list-style-type: none"> • Macroeconomic stability and economic growth. 	
<p>Increase public spending to social sectors</p> <ul style="list-style-type: none"> • Low funding at the regional level have impeded effective delivery of health and education services 	<ul style="list-style-type: none"> • Budget for FY01 provides for significant reallocation of public spending to poverty- targeted sectors (from 8.6 percent of GDP in FY00 to 12.1 percent in FY01). 	<ul style="list-style-type: none"> • Budget for FY02 to reflect increased allocation to poverty-targeted sectors from 12.1 percent of GDP in FY01 to 13.1 of GDP (after HIPC). • Executed public expenditure for poverty targeted sectors in FY01 consistent with budget for FY01. 	<ul style="list-style-type: none"> • Budget for FY03 to reflect increased allocation of public spending to poverty-targeted sectors from 13.1 percent of GDP in FY02 to 14 per cent of GDP in FY03 (after HIPC); budget priorities consistent with PRSP. • Executed public expenditure for poverty targeted sectors in FY02 consistent with budget for FY02 for 2001/02. 	<ul style="list-style-type: none"> • Improved social indicators. 	
<p>Improve Understanding of Poverty and Focus of Poverty Programs.</p> <ul style="list-style-type: none"> • Processing of 1999 household survey underway. Analysis of poverty on the basis of 1999 household survey, to feed into PRSP. 	<ul style="list-style-type: none"> • Launch of study to analyze poverty incidence and trends using the new 1999 Household Budget Survey. • Launch of work program for the Welfare Monitoring Unit to analyze the impact of Government policies and programs on the incomes of the poor. 	<ul style="list-style-type: none"> • Complete poverty study and impact analysis of programs by November 2001. 		<ul style="list-style-type: none"> • Improved understanding of poverty in Ethiopia. 	

Public Sector Management			
<p>Strengthen the legal framework and ethics architecture for the federal civil service.</p> <ul style="list-style-type: none"> A comprehensive Civil Service Reform Program (CSRP), launched in 1996, is ongoing at federal and regional level. A civil-service wide Code of Ethics is being prepared, in addition to the "National Charter of Citizen's Rights and Responsibilities", the basis for a modern ethics architecture. 	<ul style="list-style-type: none"> Adoption of draft Civil Service Law by Council of Ministers. 	<ul style="list-style-type: none"> Subject to approval by Council of People's Representatives, implementation of Civil Service Law Development of ethics training curriculum for federal civil servants. Adoption by Council of Ministers of Civil Service-wide Code of Conduct in line with National Charter of Citizen's Rights and Responsibilities 	<ul style="list-style-type: none"> Complete drafting of institutional charters for all federal ministries, departments, and agencies. Initiate ethics training at the federal level.
<p>Improve civil service pay and remuneration.</p> <ul style="list-style-type: none"> Inadequate pay for federal and regional civil servants has resulted in increasing incidence of moonlighting, poor work performance, and difficulties in retaining staff. 	<ul style="list-style-type: none"> Launch of diagnostic survey of job classification and grading (JCG); Complete labor market study on wage differentials between private-public sector jobs Designate criteria for integrating findings from JCG and labor market study in view of formulating a medium-term pay and employment policy 	<ul style="list-style-type: none"> Adoption by Council of Ministers of medium-term pay and employment policy for federal civil service consistent with the Macro-Economic and Fiscal Framework. 	<ul style="list-style-type: none"> Improved incentives for federal and regional civil servants, greater retention of qualified personnel.
<p>Improve performance of front-line service delivery.</p> <ul style="list-style-type: none"> Government has developed a National Service Delivery Policy to promote 'good practice' approaches to improving agency performance. There is need to better integrate the Policy with Government's budget process. 	<ul style="list-style-type: none"> Adoption by the Council of Ministers of Draft National Policy on Service Delivery. 	<ul style="list-style-type: none"> Subject to approval by Council of People's Representatives, implementation of National Policy on Service Delivery Monitor client feedback using report cards in federal institutions piloting the national Policy on Service Delivery 	<ul style="list-style-type: none"> Publication of results of client report cards on all participating federal institutions
<p>Improve transparency of personnel management system.</p> <ul style="list-style-type: none"> Government plans to develop a Human Resource Management Information System (HRMIS) that links all federal line agencies. 	<ul style="list-style-type: none"> Complete piloting of software for records and filing system and initiate roll out of the system across federal line agencies 	<ul style="list-style-type: none"> Completion of automation of all personnel data for federal civil servants in Federal Civil Service Commission and federal line agencies. Establishment of an Inter-ministerial Technical Committee to develop IT policy for systems integration by July 2001 Approval by Council of Ministers of draft IT policy. 	<ul style="list-style-type: none"> Installation of Wide Area Network and roll-out of HRMIS across federal institutions.
			<ul style="list-style-type: none"> Increased awareness among civil servants of rights and responsibilities Greater citizen participation in monitoring performance of ministries, departments, and agencies.
			<ul style="list-style-type: none"> Improved incentives for federal and regional civil servants, greater retention of qualified personnel.
			<ul style="list-style-type: none"> Improvement in managerial practices.
			<ul style="list-style-type: none"> Increased availability of personnel data real-time across federal government institutions, and select regional governments. Establishment of networked environment for federal institutions.

Public Expenditure Policy and Management	
<p>Improve planning and budgeting at the federal and regional levels to improve service delivery. Actions taken:</p> <ul style="list-style-type: none"> • Regulations issued in 1997 establishes a 3-year rolling Public Investment Plan (PIP). • A design document for a Public Expenditure Program (PEP) has been prepared for discussion. 	<ul style="list-style-type: none"> • Establish and operationalize a committee consisting of staff from the Ministry of Economic Development and Cooperation (MEDaC) and Ministry of Finance (MoF) and the donors to facilitate Government-donor dialogue on public expenditure issues.
<p>Improve predictability and timely availability of funds by adhering to a firm financial calendar.</p> <p>Actions taken:</p> <ul style="list-style-type: none"> • A financial calendar has been outlined in the government's Budget Design Manual (Version 2.1, February 2000). Planning starts in September and indicative ceilings are issued by January 	<ul style="list-style-type: none"> • Adoption by council of ministers of Macro-Economic and Fiscal Framework (MEFF) and Public Investment Program (PIP), satisfactory to IDA, leading to the budget for 2002/03 by October 2001 and submission to the Council of People's Representatives by December 2001. • Prepare any necessary legislation relating to the PEP and present it to the Council of People's Representatives for approval. • MEDaC, in coordination with MoF to prepare plan that lays out the resource requirements and a timetable to help the regional states in carrying forward their multi-year planning and budgeting process.
<p>Effective public service delivery through projects and programs. Integrating capital and recurrent spending. Diagnosis</p> <ul style="list-style-type: none"> • Lack of effective coordination between MEDaC and MoF in public expenditure planning and budgeting. <p>Actions taken:</p> <ul style="list-style-type: none"> • A design document for a PEP – which when implemented will subsume the PIP – has been prepared for discussion. 	<ul style="list-style-type: none"> • Adherence to the financial calendar (as specified in the Budget Design Manual) for the annual planning and budgetary cycle leading to the budget of FY03. • Estimates of subsidies to the Regions for the budget of FY03 are notified in conformity with the financial calendar (January 9 – January 16, 2002) outlined in the Budget Reform Design Manual. • Constitute a technical coordination committee with staff from MEDaC and MoF to better integrate current and capital spending by June 2001.
	<ul style="list-style-type: none"> • A review is made of the implementation of MEFF and PIP for the budget of FY02 and based on that they are rolled over for the FY03. • Begin implementation of PEP at the federal level. • Implementation of the action plan is under way.
	<ul style="list-style-type: none"> • Predictable and timely availability of funds leads to improved planning and budgeting at the regional level.
	<ul style="list-style-type: none"> • Review of the adherence to the Financial Calendar, and in particular its impact on improving the quality of planning and budgeting at the regional and sub-regional level. • Estimates of subsidies to the Regions for the budget of FY04 are notified in conformity with the financial calendar • Outline plan of action for implementing the PEP at the regional level and take steps to implement it.
	<ul style="list-style-type: none"> • Improved budgeting and planning through better balance between capital and recurrent expenditures.

<p>Improve timeliness of accounts preparation, reporting, and audit for increased transparency.</p>	<ul style="list-style-type: none"> Provide to IDA an action plan to indicate progress and future plans for improving the accounting system, in particular for reducing the current backlog of accounts preparation and reporting for audit 	<ul style="list-style-type: none"> Reduction in the backlog of accounts and audits from over 5 years to 3 years. 	<ul style="list-style-type: none"> Further reduction in backlog of accounts and audits Implementation of the reform program of the accounting system Action taken according to the audit report after its submission to the Council of Ministers. 	<ul style="list-style-type: none"> Reduction in the existing backlog of accounts preparation, reporting and audit.
<p>Improve Financial Information Management System for efficient public expenditure management.</p>	<ul style="list-style-type: none"> Agree with IDA on Action Plan to develop an improved FMIS. 	<ul style="list-style-type: none"> Implementation of the findings of the FMIS study. 	<ul style="list-style-type: none"> Review implementation of FMIS, identify areas needing further strengthening and action plan for the same. 	<ul style="list-style-type: none"> An improved financial management system.
<p>Strengthen Essential Social Services.</p>	<ul style="list-style-type: none"> Complete review of SDPs in Education and in Health 	<ul style="list-style-type: none"> Reformulation of SDPs in Health and Education in line with PRSP priorities 	<ul style="list-style-type: none"> Review of SDPs as part of PRSP review 	<ul style="list-style-type: none"> Improved education and health services.
<ul style="list-style-type: none"> Sectoral Development Programs (SDPs) in Health and Education in need of reformulation to take account of affordability, and implementation capacity. Implementation bottlenecks at a regional level have impeded implementation of SDPs 	<ul style="list-style-type: none"> Report submitted by Task Force to the MoF on implementation bottlenecks of SDPs (procurement, financial management, monitoring and reporting) 	<ul style="list-style-type: none"> Adoption of recommendations to resolve bottlenecks for improving implementation of SDPs 	<ul style="list-style-type: none"> Improvement of health and education indicators as indicated in the PRSP. 	
Private Sector Development and Export Competitiveness				
<p>Increase private investment and private sector participants.</p> <p>Diagnosis:</p> <ul style="list-style-type: none"> Cumbersome processes and regulatory framework for private sector development. 	<ul style="list-style-type: none"> Sign contract with consultants to initiate agreed study to identify regulations which hinder private sector development (study expected to be completed by March 2002). 	<ul style="list-style-type: none"> Begin implementation of action plan to implement study proposals 		<ul style="list-style-type: none"> Improved and simplified regulatory framework for private sector development.
<p>Put export promotion at the center of the political agenda.</p> <p>Actions taken:</p> <ul style="list-style-type: none"> Creation of Export Promotion Council chaired by Prime Minister 	<ul style="list-style-type: none"> Export Promotion Council to reestablish its regular meetings to provide a forum of discussion to improve environment for exports 			<ul style="list-style-type: none"> Feedback from exporters and export service industry to Export Promotion Agency and Government.
<p>Improve access to imported inputs</p> <p>Actions taken:</p> <ul style="list-style-type: none"> Duty drawback system introduced and simplified 	<ul style="list-style-type: none"> Adoption by Council of ministers of new Voucher-based duty Exemption scheme, open to all exporters with a genuine export order and to exporters using Franco-valuta imports 	<ul style="list-style-type: none"> Prepare standard coefficients for imported inputs needed for most common exports in order to facilitate the application of the voucher scheme 	<ul style="list-style-type: none"> Assessment of performance of voucher-based duty exemption scheme. 	<ul style="list-style-type: none"> Simplified access to duty-free inputs for export production.

<p>Improve access to export finance</p> <p>Diagnosis:</p> <ul style="list-style-type: none"> Limited access to export finance prevented exporters from expanding business beyond their financial capacity. <p>Actions taken:</p> <ul style="list-style-type: none"> Export Credit Guarantee scheme introduced, yet not taken up by exporters/banks. 	<ul style="list-style-type: none"> National Bank of Ethiopia (NBE) to issue Amended Directive on Export Credit Guarantee Scheme allowing participating banks to charge market interest rates, limiting the maximum collateral requested to new entrants and simplifying eligibility criteria. 	<ul style="list-style-type: none"> Export Credit Guarantee directive operational by July 2001 Suppliers Credit Directive to be extended to cover suppliers credit for inputs on a cash basis. NBE to allow for automatic registration, and drop debt/equity ratio requirement for supplier's credit. 	<ul style="list-style-type: none"> Assessment of performance of Export Credit Guarantee Scheme and Suppliers Credit. 	<ul style="list-style-type: none"> Improved access to credit for exporters; increased export activity.
<p>Eliminate remaining ex-post price monitoring on exports</p> <p>Actions taken:</p> <ul style="list-style-type: none"> Government eliminated ex-ante price controls (except for coffee), but ex-post price controls remain for many products. <p>Last remaining export ban exists for raw hides and skins.</p> <p>Diagnosis:</p> <ul style="list-style-type: none"> Export ban on raw hides and skins prevents exporters to benefit from an important export market. 	<ul style="list-style-type: none"> The coverage of NBE export price will be restricted only to products where international prices are available from recognized international sources Export price information responsibility to be shifted out of NBE to Export Promotion Agency 	<ul style="list-style-type: none"> Replace export ban on raw hides and skins with export duty. • Remove all conditions on privatized tanneries to move into specific new processes. 	<ul style="list-style-type: none"> Greater flexibility of exporters to enter markets with fierce price competition. 	<ul style="list-style-type: none"> Greater marketing flexibility for producers of raw hides and skins.
<ul style="list-style-type: none"> Slow and cumbersome customs regulation harm exporters. 	<ul style="list-style-type: none"> The requirement for the presentation of the Standards Authority's quality certificate as a condition for export clearance where the buyer confirms his/her acceptance of a different specification, or internationally accepted standard, and his/her acceptance of certification of compliance by a party other than the Authority will be waived. 	<ul style="list-style-type: none"> Prepare a study on the process of approving and cleaning of export shipment. 	<ul style="list-style-type: none"> Begin implementation of the study 	<ul style="list-style-type: none"> Simplified customs procedures for exporters.
<p>Attract Foreign Investment</p> <p>Diagnosis:</p> <ul style="list-style-type: none"> Numerous restrictions prevent Ethiopia from benefiting from foreign direct investment. <p>Actions taken</p> <ul style="list-style-type: none"> Introduction of Ethiopian Investment Authority. Review of Investment Code. 	<ul style="list-style-type: none"> Eliminate case by case screening of investments and related investment licensing for investments not specified in the Negative Lists (four lists under the Investment Code which specify the areas of activity where private investment is restricted). Eliminate minimum investment requirement for 100% export investments. 	<ul style="list-style-type: none"> Review minimum investment requirement for foreign investors. 	<ul style="list-style-type: none"> Simplified investment procedures. 	

<p>Continue privatization of parastatals. . . encourage private sector participation in infrastructure.</p> <p>Actions taken:</p> <ul style="list-style-type: none"> Government has undertaken large scale privatization program, remaining task is bringing to point of sale 111 enterprises; to be completed between 200.0/01 and 2002/03 <p>Enhance regulatory framework for utility sectors, improving transparency and competition.</p>	<ul style="list-style-type: none"> Complete preparation for privatization of 21 enterprises (i.e. compile all documentation necessary to send invitation to tender) Initiate preparation for privatization of 13 enterprises (i.e. select winning bidders to undertake the preparation for privatization) 	<ul style="list-style-type: none"> Bring to the point of sale at least 10 enterprises (between January 2001 and September 2001) Bring to the point of sale at least 40 enterprises between January 2001 and the end of the 2001/02, and complete preparation for privatization of at least 20 enterprises 	<ul style="list-style-type: none"> EPA to complete the privatization program of 111 state owned enterprises which had begun in 2000/01. 	<ul style="list-style-type: none"> Public sector retraction from private sector activities.
<p>Improve the functioning of the urban land market.</p> <p>Diagnosis:</p> <ul style="list-style-type: none"> Investors face a number of difficulties with regard to the process of lease acquisition, price and structure of lease and use of land as collateral. 		<ul style="list-style-type: none"> Allow foreign private sector participation in the Ethiopian Telecommunication corporation Launch of study to examine the relevant regulatory framework in key public utilities (gas, electricity, water) Recommend that each region establish and maintain a Register of Land available for investors (to include all charges and rights over each parcel of land fully investigated) Recommend that regional governments to enter into negotiated arrangements with private investors to develop industrial parks. Review the Urban Lands Lease Proclamation (80/1993) to ensure that banks taking leases as collateral are able to realize the full value of that collateral at any time 	<ul style="list-style-type: none"> Implementation of study recommendations 	<ul style="list-style-type: none"> Greater transparency of land availability; better access to land for potential investors.
<p>Increase agricultural productivity.</p> <ul style="list-style-type: none"> Government established a sound national fertilizer policy. However, the marketing of domestic fertilizer has been progressively reverting to a state-controlled fertilizer procurement and distribution system. Growing mismatch between the declining number of active fertilizer importers and expanding fertilizer import requirements. 	<ul style="list-style-type: none"> Sign contract with the selected consulting firm to conduct agreed study on fertilizer marketing and credit. Pending the development of an action plan based on the agreed study, Government will recommend to all regional governments to procure fertilizer for distribution under its extension programs only on the basis of competitive bidding procedures, as is already the practice in some regions. 	<ul style="list-style-type: none"> Pending the results of the study, limit government's direct supply of inputs to the Extension Intervention Program farmers to no more than two years (three years in woredas where alternative channels are not available). Prepare action plan based on the recommendations of the study on fertilizer marketing and credit, and time-table for implementation. 	<ul style="list-style-type: none"> Implementation of action plan 	<ul style="list-style-type: none"> Ensure competitive market in fertilizer imports and domestic marketing.

Annex C: ETHIOPIA - Economic Structural Adjustment Credit – Policy Matrix

(P074585; Loan/Credit C3666);

Objectives/Issues	Progress to date	Actions before Board Presentation	Future Steps: FY03 and Beyond	Outcomes
Maintaining Poverty Focused Macroeconomic Policies				
Maintain macroeconomic stability and growth	<ul style="list-style-type: none"> Real GDP growth in 2000/01 was 7.9 percent and inflation turned negative; current account deficit (before transfers) increased; Balance of payment remains vulnerable due to continuous decline in export coffee prices 	Satisfactory performance under agreed macroeconomic framework	Satisfactory performance under agreed macroeconomic framework	Macroeconomic stability and growth
Increase public spending to poverty sectors	<ul style="list-style-type: none"> Poverty –targeted expenses increased from 8.4 percent of GDP in 1999/00 to 10.9 percent of GDP in 2000/01. Expected allocation to increase to 14.9 percent of GDP in 2001/02. 	Budget for 2002/03 to reflect increased allocation to poverty -targeted sectors	Budget for 2002/03 to reflect increased allocation to poverty -targeted sectors	Improved social indicators
Implement poverty alleviation strategies	<ul style="list-style-type: none"> Completed Interim Poverty Reduction Strategy Paper (2001) Completed consultations for PRSP Undertaken a poverty analysis on the basis of the 1999/00 Household Survey and initiated work on poverty and growth 	Prepare draft PRSP	Submit to IDA and IMF a full PRSP	<ul style="list-style-type: none"> Broadly owned poverty reduction strategy Improved information flows on poverty outcomes and strategies for reducing poverty
Promoting Private Sector Development				
Improving the business environment				
Strengthen the regulatory and institutional framework for domestic competition, consumer protection and unfair trade policy	Prepared a preliminary first draft of the Competition Law	<p>Approval by Council of Ministers of a draft Competition Law, to address:</p> <ul style="list-style-type: none"> anti-competitive practices consumer protection unfair trade practices 	Subject to Parliament's approval of the authority to oversee the functioning of the competition law	<ul style="list-style-type: none"> Reduction of anti-competitive/consumer and rent-seeking activities. Fair, transparent, and efficient functioning of domestic market competition.
Improve the functioning of the land market	<ul style="list-style-type: none"> Land legislation include the Urban Land Lease Holding (Proclamation No. 80/1993) and the Federal Rural Land Administration (Proclamation No. 89/1997). Regions deal with land administration issues A national conference to revise the implementation of urban land lease policies was held on December 2001 	<p>Approval by the Council of Ministers of a draft amended federal urban land lease proclamation revised to (i) secure rights to hold and transfer leases; (ii) remove constraints on the secondary lease market and (iii) establish the use of leasehold rights as collateral</p>	Subject to approval by Council of People's Representatives of the Federal Urban Land Lease Proclamation: implement ancillary legislation review relevant legislation to ensure consistency with revised Federal Urban Land Lease Proclamation	<ul style="list-style-type: none"> Better access to land for potential domestic and foreign investors Increased tenure security; improved lease market
Diagnosis <ul style="list-style-type: none"> Investors face difficulties with regard to the process of lease acquisition, price and structure of lease and use of land as collateral 				
Improve FDI regime to attract 100 percent exporting foreign investors	<ul style="list-style-type: none"> Introduction of the Ethiopian Investment Agency (EIA) in 1994 	<p>Approval by the Council of Ministers of a draft Investment Code revised to:</p> <ul style="list-style-type: none"> Remove the minimum investment 	<ul style="list-style-type: none"> Review the minimum investment requirements for FDI, the registration and approval requirement for 	<ul style="list-style-type: none"> Higher investment and growth

Objectives/Issues	Progress to date	Actions before Board Presentation	Future Steps: FY03 and Beyond	Outcomes
<p>Diagnosis:</p> <ul style="list-style-type: none"> The Investment Code allows FDI in a limited set of activities and does not cover non equity foreign technical collaborations Lack of activities to promote FDI 	<ul style="list-style-type: none"> Reviews of the Investment Code in 1996 and 1998 	<p>requirement for 100 percent export-oriented activities</p> <ul style="list-style-type: none"> Transfer the administration of duty-free capital good imports for 100 percent export-oriented investments from EIA to the Customs Administration Promote export-oriented non-equity based foreign collaboration 	<p>technology agreements</p> <ul style="list-style-type: none"> Simplify procedures to obtain work permits and visas Consider the possibility of private participation in infrastructure sectors 	<ul style="list-style-type: none"> Higher export-oriented foreign investment and collaboration
<p>Reduce direct participation of the State in the economy</p>	<p>Government has undertaken large scale privatization program since 1995. During 2000/01, 29 enterprises were brought to the point of sale</p>	<p>During July 2001 to April 2002, bring to the point of sale (i.e. publicly invite bids) 37 enterprises</p>	<p>EPA to complete the privatization program of 111 state owned enterprises which had begun in 2000/ 01</p>	<p>Reduction of the role of the state in the economy, improved competition</p>
<p>Reducing Transaction Costs</p>				
<p>Remove regulatory constraints in the shipping and forwarding markets.</p>	<p>ESL has commissioned a major strategy study, to prepare for eventual removal of protection</p>	<p>Adoption by the Ministry of Trade and Industry of a directive:</p> <ul style="list-style-type: none"> Mandating that a single bill of lading be issued by ESL for each consignment, naming the actual importer as consignee Establishing a Unit, within the MTI, for the monitoring on a regular basis, of prices, service quality, practices and overall performance of ESL, including review of countries subject to ESL's monopoly rights 	<p>Continue step by step reduction in protection and prepare ESL for full commercial viability</p>	<p>Reduction of transaction costs, increased quality of service; improved user choice</p>
<p>Diagnosis</p> <p>Current rule requires shipping space for imports to be through ESL [On basis of Letter from Deputy PM to NBE 1999]</p>	<p>ESL has commissioned a major strategy study, to prepare for eventual removal of protection</p>	<p>ESL has commissioned a major strategy study, to prepare for eventual removal of protection</p>	<p>ESL has commissioned a major strategy study, to prepare for eventual removal of protection</p>	<p>ESL has commissioned a major strategy study, to prepare for eventual removal of protection</p>
<p>Diagnosis</p> <ul style="list-style-type: none"> Protection of ESL adds substantially to costs, and reduces service quality. ESL's practice of consigning goods to MTSE adds costs, delays and uncertainties 	<p>New runway under construction, ready March 2002, which will accommodate wide-body jets with full loads</p> <p>Civil Aviation Authority (CAA) is open to non EAL charters. Some allowed already</p>	<p>Civil Aviation Authority to issue a Circular which defines the specific conditions under which air cargo charter flights may operate to and from Ethiopia</p>	<p>After separation of CAA into regulatory and operations bodies, the latter to enter ground handling market in competition with EAL</p>	<p>Increase cargo space availability and quality of service to exporters</p>
<p>Improve quality of service to exporters by extending competition in air cargo charter market</p>	<p>Separation of postal and telecom services</p> <p>Separation of regulatory and operation functions of telecom by establishment of Ethiopian Telecommunications Authority (ETA) and Ethiopia Telecommunications Corporation (ETC)</p> <p>Launch of GSM service by ETC</p>	<p>Submit to Council of Ministers a Communications Policy including:</p> <ol style="list-style-type: none"> sector vision and strategy to reach universal access options for the participation of strategic partners in ETC timetable for liberalization of market and additional private participation in the sector 	<p>Preparation of ETC for strategic partnership</p> <ul style="list-style-type: none"> Adoption and implementation of options of Communications Policy Enhance the frequency management capacity of ETA 	<p>Preparation of ETC for strategic partnership</p> <ul style="list-style-type: none"> Adoption and implementation of options of Communications Policy Enhance the frequency management capacity of ETA
<p>Significant expansion of access to telecommunications services and increase fiscal contribution of the sector</p>	<p>Separation of postal and telecom services</p> <p>Separation of regulatory and operation functions of telecom by establishment of Ethiopian Telecommunications Authority (ETA) and Ethiopia Telecommunications Corporation (ETC)</p> <p>Launch of GSM service by ETC</p>	<p>Submit to Council of Ministers a Communications Policy including:</p> <ol style="list-style-type: none"> sector vision and strategy to reach universal access options for the participation of strategic partners in ETC timetable for liberalization of market and additional private participation in the sector 	<p>Preparation of ETC for strategic partnership</p> <ul style="list-style-type: none"> Adoption and implementation of options of Communications Policy Enhance the frequency management capacity of ETA 	<p>Preparation of ETC for strategic partnership</p> <ul style="list-style-type: none"> Adoption and implementation of options of Communications Policy Enhance the frequency management capacity of ETA
<p>Diagnosis</p> <ul style="list-style-type: none"> Very low penetration of telecom services due to extensive monopoly rights of 	<p>Separation of postal and telecom services</p> <p>Separation of regulatory and operation functions of telecom by establishment of Ethiopian Telecommunications Authority (ETA) and Ethiopia Telecommunications Corporation (ETC)</p> <p>Launch of GSM service by ETC</p>	<p>Submit to Council of Ministers a Communications Policy including:</p> <ol style="list-style-type: none"> sector vision and strategy to reach universal access options for the participation of strategic partners in ETC timetable for liberalization of market and additional private participation in the sector 	<p>Preparation of ETC for strategic partnership</p> <ul style="list-style-type: none"> Adoption and implementation of options of Communications Policy Enhance the frequency management capacity of ETA 	<p>Preparation of ETC for strategic partnership</p> <ul style="list-style-type: none"> Adoption and implementation of options of Communications Policy Enhance the frequency management capacity of ETA

Objectives/Issues	Progress to date	Actions before Board Presentation	Future Steps: FY03 and Beyond	Outcomes
<p>the ETC, limited fiscal contribution</p> <p>Increasing export competitiveness</p> <p>Ensure free trade status regime for 100 percent exporters.</p> <p>Diagnosis:</p> <ul style="list-style-type: none"> Ineffective duty-free import schemes contribute to the lack of interest from foreign investors in Ethiopia's export-oriented industries. 	<ul style="list-style-type: none"> The Proclamation to Establish Export Duty Incentive Scheme was approved in July 2001. 	<p>Submission to the Council of Ministers of an amendment to the Proclamation 249/2001 removing the requirement for input-output coefficients in the BMW scheme</p>	<ul style="list-style-type: none"> Customs Authority to issue a Directive which implements the Bonded Manufacturing Warehouse (BMW) Scheme, eliminating the requirement for input-output coefficients In parallel, Ministry of Trade and Industry Directive on BMW will be amended, to eliminate requirement for input-output coefficients 	<p>Improved manufactured export performance</p>
<p>Improve finance for exports</p>	<ul style="list-style-type: none"> Suppliers Credit Directive amended in 1998. Export Credit Guarantee Scheme amended in 2001 	<ul style="list-style-type: none"> NBE to amend the Suppliers Credit Directive to remove the debt/equity ratio requirement for foreign credits and loans for exports NBE to amend Directive to reduce the 2 percent service charges imposed on Franco-Yaluta imports for exporters 	<ul style="list-style-type: none"> Assess the effectiveness of the Revised Credit Directive Assess the operational performance of the Revised Export Credit Guarantee Scheme 	<p>Improve sources of finance for exports</p>
<p>Improve coffee exports</p> <p>Diagnosis</p> <ul style="list-style-type: none"> Ongoing review of coffee export marketing system, including current regulatory environment. 	<ul style="list-style-type: none"> Program to introduce Warehouse Receipts has been started – to facilitate the development of the Commodity Exchange System Action taken to curb serious problem of coffee auction bidders not honoring bids. System of Special Auction Accounts introduced, and working successfully 	<p>Prepare ToR for a study to consider and review all issues pertaining to coffee marketing with a view of setting up an efficient coffee commodity exchange. Design a self contained regulatory framework for a commodity exchange</p>	<p>Carry out study and review recommendations with all concerned parties prior to implementation</p>	<p>Improved marketing and exporting of coffee</p>
<p>Improve marketing arrangements for hides and skins</p> <p>Diagnosis</p> <ul style="list-style-type: none"> Ongoing review of how best to maximize returns from hides & skins 	<ul style="list-style-type: none"> Privatization of tanneries Increased tanning capacity Livestock Marketing Authority is preparing program to broadcast prices of hides and skins on a regular basis 	<ul style="list-style-type: none"> Prepare TOR for study of market for raw hides and skins. This study to consider overall impact of transforming export ban into tariff Set up Steering Committee to lead the study, including representatives from farmers, traders, processors 	<p>Carry out study and review recommendations with all concerned parties prior to implementation</p>	<p>Greater marketing flexibility for producers of raw hides and skins</p>
Improving Public Sector Management and Service Delivery				
<p>Strengthening the civil service strategic and legal framework for the civil service (CS)</p>	<ul style="list-style-type: none"> A Civil Service Law was approved by the Council of People's Representatives in December 2001 and published in the Negarit Gazette 	<p>Approval by Council of Ministers of civil service grievance system and procedures</p>	<p>Civil service training on the legal and procedural aspects of the civil service law and related directives</p>	<p>Enforcement of modern civil service rules and regulations in line with principles of transparency, merit, performance, and recognition of rights and responsibilities</p>

Objectives/Issues	Progress to date	Actions before Board Presentation	Future Steps: FY03 and Beyond	Outcomes
<p>Improving expenditure management and prioritization</p> <p>Introduce medium-term planning and budgeting at the federal and regional levels</p>	<ul style="list-style-type: none"> A new budget manual (version 2.1, February, 2000) that outlines changes in the processes and structure of the Federal Government's budget has been introduced. A new budget classification scheme, outlined in the manual, has been adopted in the FY02 budget. A similar manual is planned for use by regional states A financial calendar has been outlined in the government's Budget Manual, Version 2.1 	<ul style="list-style-type: none"> Approval by the Council of Ministers and subsequent notification to the Council of People's Representatives of the Macro-Economic and Fiscal Framework (MEFF) and the 2002-04 Indicative Planning Indicators Ministry of Finance and Economic Development initiates technical assistance to select regions on carrying forward their multi-year planning and budgeting 	<ul style="list-style-type: none"> The financial calendar is adhered to for the overall annual planning and budgetary cycle leading to FY04 budget Review of implementation of the new financial calendar for FY03 budget, and report to House of People's Representatives with commitment for timely notification of FY04 subsidies and two-year subsidy projections to regions 	<ul style="list-style-type: none"> Budget planning and formulation are forward looking, based on a medium-term perspective Reduction in budget uncertainty leading to better resource planning at all levels of government
<p>Integrate budgeting and planning of recurrent and capital expenditures</p>	<p>MEDaC and MoF have been merged into a single ministry—the Ministry of Finance and Economic Development</p>	<p>Issuance of a joint budget call for the submission of 2002/03 capital and recurrent budgets</p>	<p>Recurrent and capital spending are jointly classified by programs</p>	<p>Enhanced and/or productive life of assets created by capital spending (e.g., roads and bridges; education and health facilities)</p>
<p>Enhancing incentives to perform</p> <p>Revise pay and grading system to motivate staff and improve productivity. Reduce incidence of moonlighting, migration to the private sector, and poor work performance</p>	<ul style="list-style-type: none"> Implementation of across-the-board salary increase for all civil servants within FY02 budget year Draft diagnostic survey of Job Classification and Grading (JCG) completed and new job groupings completed and being reviewed 	<ul style="list-style-type: none"> Completion of job classification and grading exercise, including finalization of new job groupings and grades Launch labor market surveys against 1999 benchmarks and for new grades 	<p>Implementation of medium-term pay and grading reform for federal civil servants, costed within macro-fiscal targets to be incorporated in the FY04 PEP</p>	<ul style="list-style-type: none"> More efficient and responsive civil service institutions Higher retention rates, particularly for managerial and technical staff
<p>Introduce performance management across agencies and local government</p>	<ul style="list-style-type: none"> Government has adopted a National Service Delivery Policy to promote 'good practice' approaches to public sector management. Ministry of Capacity Building is preparing framework for Performance and Service Improvement Program (PSIP) 	<p>Develop and initiate implementation of PSIP in key agencies at the federal level and select regional bureaus</p>	<p>Implementation of PSIP in federal agencies, and corresponding bureaus in regions</p>	<p>Greater compliance and mainstreaming of CSRP initiatives at agency-level, with resulting improvements in operational performance</p>
<p>Improving fiscal monitoring and accountability</p> <p>Improve monitoring of financial management practices through timeliness of accounts preparation and auditing</p>	<ul style="list-style-type: none"> The Department of Accounts prepared a plan for improving the accounting system, including reduction of accounts and audit backlog The new accounting system is adopted in the FY03 budget, incorporating double entry and modified cash system (as specified in the Budget Design Manual) 	<ul style="list-style-type: none"> Elimination of backlog of accounts at the federal level; consolidation of the federal and regional accounts for 1999/00; and initiation of the financial audits for 1999/00 Preparation of roll-out plan for Budget, Disbursements, Accounts (BDA) system, incorporating the new budget structure in the regions and 	<ul style="list-style-type: none"> Eliminate backlog of accounts for all expenditures, reduce backlog for audits to one year. Timely corrective actions are taken on the basis of audit reports. Complete roll-out of BDA system, incorporating double entry, at federal 	<ul style="list-style-type: none"> Improved quality of fiscal data and compliance with financial regulations Sound financial management practices and output performance

Objectives/Issues	Progress to date	Actions before Board Presentation	Future Steps: FY03 and Beyond	Outcomes
<p>Improve transparency of personnel practices in a decentralized civil service system</p>	<ul style="list-style-type: none"> The design study for the integrated financial management system (IFMS) and bidding documents prepared to procure a package solution The Government is preparing, together with IDA, a Country Financial Accountability Assessment (CFAA) and a Country Procurement Assessment Review (CPAR) Piloting of software for records and filing system, and automation of personnel records for 10 percent of federal civil servants completed 	<p>transition to IFMS</p> <ul style="list-style-type: none"> Review of options for using wireless technology for development of Wide Area Network 	<p>and regional levels</p> <ul style="list-style-type: none"> Undertake customization and piloting of IFMIS package at federal level Implementation of agreed recommendations from the CFAA and the CPAR 	<ul style="list-style-type: none"> Accurate and timely personnel data reflecting all relevant personnel actions undertaken by line agencies Real-time monitoring of personnel management in line agencies
		<ul style="list-style-type: none"> Automation of 50 percent of all personnel records at the federal level, and preparation of an action plan for the reconciliation of such records with the payroll data 	<ul style="list-style-type: none"> Automation of all existing personnel records Upgrade of existing records and filing system to develop Human Resource Management Information System Roll-out of upgraded system to line agencies with training of end-users 	

Annex D: Ethiopia First Poverty Reduction Support Credit- Policy Matrix

Actions in bold text for PRSC I represent the prior actions. Actions in bold text for PRSC 2 represent triggers. All other actions are benchmarks. (P074014; Loan/Credit H0730);

Policy Area	Actions to be completed before:		Outputs by PRSC-III	
	PRSC-I	PRSC II	By PRSC-III:	
PUBLIC INSTITUTIONAL PERFORMANCE				
<p><i>Theme Goal:</i></p> <ul style="list-style-type: none"> Fully democratic, operational constitutional federalism active at federal, regional and local levels. Improved responsiveness of service delivery and deepened democratic empowerment at the grassroots level. <p><i>Overall Theme Outcomes:</i></p> <ul style="list-style-type: none"> Predictability of financial resource flows (in-year and across years) as measured by reduced budget variances and timely transfer of resources from federal to regional levels and regional to woreda levels Increased resources focused on service delivery at regional level and below as measured by a reduced fiscal gap Increased fiscal autonomy at regional level and below as measured by increasing percentage of unearmarked transfers and locally raised revenues Decreased transaction costs for business when dealing with government as measured by reduced transaction costs and processing times 	<p>MoFED issuance of directive on financial calendar; and implementation of two actions (Cabinet approval of Macro-Economic and Fiscal Framework for 2004/05-2006/07 and MOFED issuance of Indicative planning figures for Federal regional subsidy and Federal specific purpose grants)</p>	<p>Revise the financial calendar and issue a directive on strategic planning management, consistent with MEFF, PIP/PEP, and annual budgeting cycle</p>	<p>Implement financial calendar</p>	<p>Alignment of SDPRP, planning and budget cycle and sectoral review cycles</p> <p>Transition to integrated, medium-term budgeting system</p> <p>Integration of DBS donors' review processes and budget commitment processes within the government financial calendar</p> <p>Timely notification of federal/regional transfers and regional/woreda transfers</p>
<p>Improving public financial management</p>	<p>Adoption of new chart of accounts by Regional Cabinets of four regions</p> <p>10 regions with accounts backlog</p> <p>Reduction of the audits backlog for the federal accounts to two years</p>	<p>Adoption of new chart of accounts by nine regions</p> <p>All federal institutions and 3 regions completing roll-out of modified cash, double entry accounting and BDA3</p> <p>8 regions with accounts backlog</p> <p>Amendment of proclamation to set time limit for the submission of draft government accounts to the Federal Auditor General</p> <p>X% of federal budgetary units would prepare standardized internal audit reports</p> <p>Reduction of the audits backlog for the federal accounts to one year</p>	<p>Adoption of new chart of accounts by all eleven regions</p> <p>8 regions completing roll-out of modified cash, double entry accounting and BDA3</p> <p>6 regions with accounts backlog</p> <p>Audit backlog for federal accounts is cleared</p>	<p>Increasing timeliness in the availability of audited financial information at federal and regional levels</p>
<p>Information Technology and Systems</p>	<p>ICT Development Authority established</p>	<p>Preparation of Government formation System Strategy(GISS) with</p>	<p>GISS Applications Road Map expanded to include sectoral</p>	<p>Establishment of legal and institutional framework for ICT applications in the</p>

	6 federal budgetary units completing roll out of Budget Information Systems software Integrated Financial Management System (IFMIS) study revised according to CFAA report.	Applications Road Map for financial, human, and land information systems 21 federal budgetary units completing roll out of BIS software Implementation of IFMIS at 5 pilot budgetary units at federal level	information systems All federal budgetary units completing roll out of BIS software IFMIS roll out in all budgetary units at federal level and pilot testing at selected regions.	public sector Complete implementation of existing (interim financial information systems at federal level) Considerable advance in implementing final financial information systems at federal and regional levels
Procurement	Issuance of circular on devolution of procurement responsibilities from MoFED to federal budgetary institutions.	Procurement Proclamation passed by Parliament Procurement Unit in the MOFED transformed into a Regulatory Directorate	Procurement Law and Directives implemented at Federal and four Regional Governments Regional Regulatory bodies established in four Regions	Establishment of legal and institutional framework for procurement Control and resource mechanisms for procurement established
Legal framework for functional assignment in woredas and municipalities	Enabling legislation to assign expenditure and revenue responsibilities to municipalities enacted in 4 regions and Addis Ababa	Enabling municipal legislation in two other regions	Enabling municipal legislation in four other regions	
Intergovernmental fiscal transition	Establishment of federal specific purpose capacity building or PSCAP program to support transformation at the federal, regional, and local levels	Enabling legislation to assign expenditure and revenue responsibilities for woredas enacted by four regions (covering 430 such woredas) Provision of line item in the federal budget to meet one-off transitional costs, i.e., one-off logistics and infrastructure costs, of decentralization in woredas House of Federation approval of the updated grant formula for federal-regional transfer Cabinet approval of fiscal decentralization strategy for municipalities and woredas	Enabling legislation for woredas enacted by five regions (covering 60 such local jurisdictions) Implementation of fiscal decentralization policy including recurrent transfers to municipalities and capital funding mechanism for municipalities and woredas	Completion of the process of matching assignment of expenditure and revenue in woredas and municipalities Formal fiscal transition for decentralization implemented in all reforming regions Increased alignment between finance and function for local governments
Human Resource Management	Adoption by federal institutions of the Results-Oriented Performance Evaluation (ROPE) system	Remuneration policy for federal and regional levels adopted	Federal remuneration policy implemented	Improved efficiency and quality of human resource management practices Increased wage decomposition ratios and increased convergence between mean public-private wage comparators

<p>Performance Management</p>	<p>Restructuring and performance improvement initiated for Addis Ababa and 16 towns; and PSIP pilots initiated in 11 Ministries, Authorities, and Bureaus.</p>	<p>[Number to be provided] Additional Ministries, Agencies and Bureaus implement Performance Service Improvement Program at Federal level</p>	<p>[Number to be provided] Additional Ministries, Agencies and Bureaus implement Performance Service Improvement Program at Federal level</p>	<p>Increased percentage of MABs (at federal level and in each region), woredas and municipalities implementing performance improvement</p> <p>Increased percentage of public expenditures at federal, regional and local levels outsourced</p>
<p>Monitoring & Evaluation</p>	<p>Issuance by CSA of guidelines and service standards to ensure timely release of and access to raw statistical data</p>	<p>Satisfactory implementation of monitoring and evaluation plan</p>	<p>Results of Welfare Monitoring Survey and HICES 2003/04 disseminated</p>	<p>M&E of performance improvement measures continued</p>
<p>RURAL DEVELOPMENT AND VULNERABILITY</p>				
<p>Theme Goal: <ul style="list-style-type: none"> • Growth in rural incomes consistent with a reduction of people below the poverty line Overall theme Outcomes: <ul style="list-style-type: none"> • Average agricultural GDP growth of 12 and crop GDP growth of 14.3% between 2002/03 to 2004/05 • Increased growth rate of off-farm income • Decrease in percentage of stunted children under 5 and 57% in 1999/00 to 50% in 2004/05 and wasted children from.% in 2004/05 </p>				
<p>Agricultural research and extension system</p>	<p>Percentage of extension staff without responsibility for delivery of inputs and credit administration increases to 70% and share of annual fertilizer sales with regional government guarantees reduced to 200,000 metric tonnes</p>	<p>Percentage of extension staff without responsibility for delivery of inputs and credit administration raised to 85% and share of annual fertilizer sales with regional government guarantees reduced to 100,000 mt</p>	<p>Percentage of extension staff with no responsibility for delivery of inputs and credit administration raised to 100% and complete phase out of regional government guarantees for fertilizer sales</p>	<p>Improved effectiveness and responsiveness of research and extension system as measured by 6 million farmers adopting tested technologies and 15% of women farmers being reached by extension agents</p>
<p>Agricultural marketing system</p>	<p>Warehouse receipt law passed</p>	<p>Conduct a study to explore the options for reforming the market structure for the import and distribution (including wholesale and retail) segments of the fertilizer market and adopt policy to reform fertilizer marketing system including import and distribution segments based on recommendations of study</p>	<p>Implement policy</p>	<p>Improved agricultural marketing systems, including export as measured by increased number (TO BE DETERMINED) of active participants (including cooperatives and traders) in fertilizer, grain, and livestock markets at retail and wholesale level</p>
		<p>Undertake and evaluate warehouse receipt pilot</p>	<p>Implement evaluation findings, including scaling up if appropriate</p>	<p>Warehouse receipt system in place and functioning</p>

Land tenure	Issue Rural Land Proclamations to enhance land tenure security and a directive to establish appropriate land administration institutions in four major regions	Issue Rural Land Proclamations to enhance land tenure security and a directive to establish appropriate land administration institutions in two other emerging regions	Issue Rural Land Proclamations to enhance land tenure security and a directive to establish appropriate land administration institutions in two other emerging regions and harmonize as appropriate regional proclamations based on emerging best practices	Improved land tenure security, with more flexible and transferable rights as measured by increased number (TO BE DETERMINED) of farm households with land use certificates and long term leases for their land holdings
Vulnerability	Refocused DPPC's mandate on needs of unpredictable food insecurity caseload	Define institutional arrangements, implementation modalities and monitoring mechanisms for a system of multi-annual productive safety nets and begin implementation	Expand implementation of multi-annual productive safety nets	Differentiate public response to predictable vs. unpredictable food insecurity as measured by 3 million of predictable food insecure population benefiting from multi-annual productive safety nets including public works, conditional transfer programs, and other programmes for the most vulnerable. Improved public response to shocks and access to consumption smoothing mechanism as measured by 6% of food security program financed from government treasury funds Increased access to more productive land
	Circular issued to regions confirming that access to federal specific purpose grant for food security will require compliance with guidelines for mitigating social and environmental risk under the Access to New Land Program upon finalization of such guidelines	Participatory review of implementation experience and subsequent revision of risk mitigation strategy		
PRIVATE SECTOR DEVELOPMENT				
<p><i>Theme Goals:</i></p> <ul style="list-style-type: none"> • Real GDP growth rate recovers from estimate of 3.8% in 2002/03 to 6.7% in 2003/04 and 6.4% in 2004/05 • Overall theme outcomes • Increased factor productivity to be measured by share of prorate investment in GDP increasing from 9% in 2002 to 13% in 2004/05 				
Competition.	Appointment of members of Competition Commission Satisfactory progress towards establishment of Competition Secretariat	Finalization of Commission & Secretariat, and formulation of regulations, through consultations with the Private Sector	Test new regulations in two sectors and publication of results	Improved enforcement of competition policy to be measured on the basis of indicators to be developed during the program period

Regulatory Burden	Reduction in cost of new business registration from \$425 to \$65 and time of registration from 44 days to 8 days	Reduction in time of customs processing	Reduced regulatory burden as measured by specified reductions in measures undertaken
Trade	Submission of application for accession to WTO	Memorandum on Foreign Trade Regime submitted to WTO	Progress in WTO membership
Privatization.		Commence implementation of agreed measures for accelerating privatization program	Reduction of the role of the public sector in commercial activities as measured by public enterprise turnover as % of GDP
Urban Land.		Revise Federal urban land lease law and adopt new urban land lease proclamation in Addis Ababa	Improved efficiency of urban land lease administration as measured by reduced cost and time for acquiring leased land in Addis Ababa and, if possible, other major urban areas
Telecommunications.		Adoption of revised telecommunications policy allowing for partial liberalization of the telecommunications sector	Increased access to telephone and Internet service as measured by telecom density of 1.8%
Financial Sector.	Approval by MoFED and commencement of implementation of a restructuring plan for CBEI	Implementation of CBE restructuring Approval by MoFED and commencement of implementation of a restructuring plan for the Development Bank of Ethiopia Review micro- and rural finance strategy and develop action plan to improve access to micro- and rural finance Carry out a study on excess liquidity problem of banking sector	Increased contestability in the banking system as measured by private bank market % share of deposits (or total assets) [TBD] Increased banking system strength and efficiency as measured by reduction of non-performing loan portfolios for CBE and DBE [TBD] Total financing to the private sector (from credit, leasing and securities market sources) as 1% of GDP [TBD] Access to finance as measured by increased number of households that are clients of MFIs and increased number of bank borrowers

	Encourage public sector institutions to diversify their allocation of deposits	Improve the treasury bills/treasury bond market system	
	Strengthen CBE's retail lending operations for the rural sector	Encourage the establishment of leasing companies (issue of incentives)	
HUMAN DEVELOPMENT			
<p><i>Theme Goal:</i></p> <ul style="list-style-type: none"> Increased share of healthy and educated Ethiopians enjoying an improved standard of living access to economic opportunities, especially poor people as evidenced by the increase in life expectancy from 52 in 2000/01 to 2004/05 <p><i>Overall Theme Outcomes:</i></p> <ul style="list-style-type: none"> Increased access, completion and equity in education Reduction in the Infant Mortality Rate from 113/1000 in 2002 to 100/1000 by 2004/2005 Reduction in the Maternal Mortality Rate from 871/100000 in 2002 to 500-700/100000 by 2004/2005 Reduction of HIV Prevalence among 15-24 year old pregnant women from 12% in 2002 to 10% by 2004/2005. 			
Education sector performance.		Satisfactory progress in implementation of undertakings agreed in education sector reviews in 2004; timing to be revised in line with national budget cycle calendar	Satisfactory implementation progress of undertakings agreed in May 2005 education sector review and confirmed by October 2005 review
			Increased Access, Completion & Equity Primary enrolment(Gross Enrolment Ratios -GER-of 70%); increased completion of primary education (Grade Completion rate of 40%);increased Gender parity index(GPI) for grades 1-8 of 0.79;textbook/pupil ratio for core subject for Grades 1-8 of [TBD]; and Pupil : Teacher ratio (Grades1-8) of [TBD]
National Learning Assessment.	Completed design and implementation schedule for National Learning Assessment for Grades 4 and 8	Grade 4 and 8 sample National Learning Assessment completed	Recommendations and methodology developed for curricula revision, teacher training and other policy areas based on the results of the national learning assessment
School construction.	Primary school building design options with lower unit costs and environmental analysis are completed	Federal design options and guidelines for primary school construction with lower unit costs and community participation are validated and adopted by all Regions	
Health sector performance.		Satisfactory progress in implementation of undertakings agreed in health sector reviews in 2004; timing to be revised in line with national budget cycle calendar	Improved coverage and effectiveness of basic health services as measured by increase in EPI coverage as proportion of children receiving DPT3 vaccination to 60%; increase in proportion of deliveries

			Complete health worker study and follow-up with implementation of its recommendations Define an action plan for implementation of the population and reproductive health strategy	calendar	attended by trained personnel to 25%; and increase in contraceptive prevalence rate to 24%
Health Extension	Adoption of guidelines defining the minimum package of services at woreda level including the health extension program and related roles for health posts and health centers	Implementation of health extension package including training of health extension workers	Implement action plan of population and reproductive health strategy Revise guidelines based on a review of experience with the use of health extension workers and the efficacy of health packages.		
Nutrition		Establish a multisectoral joint coordination structure for nutrition, including a lead coordinating agency, and initiate a multisectoral process to define a strategy on nutrition	Complete and adopt the nutrition strategy Design and implement coordinated approach to food security related nutrition activities and nutrition elements of the health extension program in additional 2-3 regions		
HIV/AIDS	Establish joint MOH and HAPCO committee to facilitate piloting of an HIV/AIDS biological survey	Conduct of HIV/AIDS pilot biological survey	Report on the pilot survey and conduct the HIV/AIDS biological survey (if feasible)		

Annex E: Poverty Reduction Support Credit 2 DPL - FY05 Policy Matrix

P077749; Loan: JPN 51119, IDA H1350, JPN 5380)

Policy Area	Actions to be completed before:			Outputs By PRSC-III
	PRSC-II (by end-October 2004)	PRSC-III (by end-October 2005)	PRSC-IV (by end-October 2006)	
PUBLIC INSTITUTIONAL PERFORMANCE				
<p><i>Theme Goal:</i></p> <ul style="list-style-type: none"> Fully democratic, operational constitutional federalism active at federal, regional and local levels. Improved responsiveness of service delivery and deepened democratic empowerment at the grassroots level. <p><i>Overall Theme Outcomes:</i></p> <ul style="list-style-type: none"> Predictability of financial resource flows (in-year and across years) as measured by reduced budget variances and timely transfer of resources from federal to regional levels and regional to woreda levels Increased resources focused on service delivery at the local level as measured by the total transfer to woredas Increased fiscal autonomy at regional level and below as measured by increasing percentage of unearmarked transfers and locally raised revenues Decreased transaction costs for business when dealing with government as measured by reduced transaction costs and processing times 				
<p>Improving planning and budgeting cycle</p>	<p>Revise the financial calendar and issue a directive on strategic planning management, consistent with MEFF, PIP/PEP, and annual budgeting cycle</p>			<p>Alignment of SDRPP, planning and budget cycle and sectoral review cycles</p> <p>Transition to integrated, medium-term budgeting system</p> <p>Integration of DBS donors' review processes and budget commitment processes within the government financial calendar</p> <p>Timely notification of federal/regional transfers and regional/woreda transfers</p>

* Actions in bold text for PRSC II represent the prior actions. Actions in bold text for PRSC III represent triggers. All other actions are benchmarks.

** This column reflects the output indicators developed for the PRSC I-III series which are based on the first SDRPP. New results indicators covering future years will be developed during preparation of PRSC III, when SDRPP 2 results indicators will become available.

Policy Area	Actions to be completed before:			Outputs By PRSC-III
	PRSC-II (by end-October 2004)	PRSC-III (by end-October 2005)	PRSC-IV (by end-October 2006)	
Implementation of Sector Wide Approach for PSCAP incorporating the CSR, Tax, Justice, ICT, District Decentralization and Urban Mgt Programs	Commencement of implementation of federal specific purpose capacity building or PSCAP program to support transformation at the federal, regional, and local levels	Four regions complete minimum mandatory capacity building activities under PSCAP (including accounts backlog eliminated, BDA3/BIS roll out, training of judges, HR training, Business process reengineering, etc.)		
Improving public financial management	Adoption of new chart of accounts by 6 regions 5 federal institutions and 3 regions completing roll-out of modified cash, double entry accounting and BDA3 8 regions with accounts backlog Reduction of the audits backlog for the federal Treasury accounts to one year	Adoption of new chart of accounts by 8 regions All federal institutions and 6 regions completing roll-out of modified cash, double entry accounting and 4 regions will complete roll-out of BDA3 6 regions with accounts backlog MOFED shall issue a directive setting a date for closure of the Federal Government's accounts submission of same to OFAG and circulate the directive to federal budgetary institutions for compliance; MOFED will also send the directive issued as a prototype to Regions for their consideration and adoption Federal accounts for EFY 95 and 96 submitted to OFAG for audit Pilot Federal budgetary units would prepare standardized internal audit reports on time	Adoption of new chart of accounts by all eleven regions 3 regions with accounts backlog Audit backlog for federal accounts is cleared	Increasing timeliness in the availability of audited financial information at federal and regional levels

Policy Area	Actions to be completed before:			Outputs By PRSC-III
	PRSC-II (by end-October 2004)	PRSC-III (by end-October 2005)	PRSC-IV (by end-October 2006)	
Information Technology and Systems	21 federal budgetary units completing roll out of BIS software	All federal budgetary units completing roll out of BIS software Preparation of Government Information System Strategy (GISS) with Applications Road Map for financial, human, and land information systems	GISS Applications Road Map expanded to include sectoral information systems	Establishment of legal and institutional framework for ICT applications in the public sector Complete implementation of existing/ interim financial information systems at federal level
Procurement	Cabinet clearance and submission to Parliament of draft Procurement Proclamation for approval Procurement Department in the MOFED transformed into a Regulatory Directorate Tender Committees and procurement units strengthened and created where they do not exist at Federal Government	Procurement Law and Directives implemented by Federal Government Preparation of the prototype Regional Procurement Proclamation is finalized in four regions and submitted for consideration and approval by Regional Parliaments. Tender Committees and procurement units strengthened and created where they do not exist at the 4 Regional Governments Preparation of a Procurement Review (PR) manual completed at Federal level and Procurement Reviews carried out for 10% of entities in Federal Government	Procurement Law and Directives implemented by four Regional Governments	Establishment of legal and institutional framework for procurement Control and resource mechanisms for procurement established
Legal framework for functional assignment in woredas and municipalities	Enabling legislation for municipalities passed in 4 regions and Addis Ababa	Revised legal framework for functional assignment for four woredas (covering 430 such woredas)	Revised legal framework for functional assignment for five woredas enacted by five regions (covering 60 such local jurisdictions)	Completion of the process of matching assignment of expenditure and revenue in woredas and municipalities

Policy Area	Actions to be completed before:			Outputs By PRSC-III
	PRSC-II (by end-October 2004)	PRSC-III (by end-October 2005)	PRSC-IV (by end-October 2006)	
Intergovernmental fiscal transition	<p>Provision of funding for transitional costs related to civil works or infrastructure costs of decentralization</p> <p>Updated grant formula for federal-regional transfer submitted to House of Federation for approval</p> <p>MOFED issuance of fiscal decentralization strategy</p>	<p>House of Federation approval of the updated grant formula for federal-regional transfer</p> <p>Implementation of fiscal decentralization policy including recurrent transfers to municipalities and capital funding mechanism for municipalities and woredas</p> <p>ROPE adopted at all levels federal and regional</p> <p>Federal Civil Service Commission issuance of a white paper on remuneration policy for Federal level</p>	<p>Prototype service standards for woredas and municipalities adopted</p>	<p>Formal fiscal transition for decentralization implemented in all reforming regions</p> <p>Increased alignment between finance and function for local governments</p>
Human Resource Management	<p>Adoption by federal government and 4 regional governments of the revised result oriented performance Evaluation (RoPE) system</p>			<p>Improved efficiency and quality of human resource management practices</p> <p>Increased wage decompression ratios and increased convergence between mean public-private wage comparators</p>
Performance Management	<p>40% MABs at federal level and 10% at regional level involved in PSJP</p>	<p>50% of MABs at federal level and 20% of MAB's at regional level participating in PSIP (to be agreed)</p> <p>Results from woreda/municipality benchmarking exercise published and prototype service standards developed for woredas/municipalities</p> <p>Results of Welfare Monitoring Survey and HICES 2003/04 disseminated</p>		<p>Increased percentage of MABs (at federal level and in each region), woredas and municipalities implementing performance improvement</p> <p>Increased percentage of public expenditures at federal, regional and local levels outsourced</p>
Monitoring & Evaluation	<p>Satisfactory implementation of monitoring and evaluation plan</p>			<p>M&E of performance improvement measures continued</p>

RURAL DEVELOPMENT AND VULNERABILITY

<p><i>Theme Goal:</i></p> <ul style="list-style-type: none"> • Growth in rural incomes consistent with a reduction of people below the poverty line <p><i>Overall Theme Outcomes:</i></p> <ul style="list-style-type: none"> • Average agricultural GDP growth of 12% and crop GDP growth of 14.3% between 2002/03 to 2004/05 • Increased growth rate of off-farm income • Decrease in percentage of situated children under 5 from 57% in 1999/00 to 52% in 2004/05 				
<p>Agricultural research and extension system</p>	<p>Percentage of extension staff without responsibility for delivery of inputs and credit administration raised to 85% and share of annual fertilizer sales with regional government guarantees reduced to 100,000 mt</p>	<p>All (100%) extension staff in major agricultural producing regions (Tigray, Amhara, Oromiya, SNNPR) are fully disengaged from input supply (with no responsibility for delivery of inputs and/or credit administration)</p> <p>Capacity-building program for rural development (including extension and marketing) defined and developed, finalized, and implementation initiated</p>		<p>Improved effectiveness and responsiveness of research and extension system as measured by 6 million farmers adopting tested technologies and 15% of women farmers being reached by extension agents</p>
	<p>Agricultural marketing system</p>	<p>Agree with IDA on the TORs for a study to explore the options for reforming the market structure for the import and distribution (including the wholesale and retail) segments of the fertilizer marketing system</p> <p>Preparations completed for undertaking warehouse receipt pilot</p>	<p>Conduct study with agreed TOR to explore the options for reforming the market structure for the import and distribution segments of the fertilizer market; adopt and implement policy to reform fertilizer marketing system based on recommendations from the study</p> <p>Undertake and evaluate warehouse receipt pilot</p>	<p>Continue implementation</p> <p>Improved agricultural marketing systems with an increased number of active participants (including cooperatives and private traders) in fertilizer, grain, and livestock markets at retail and wholesale level</p>
			<p>Scale up warehouse receipt pilot as feasible per the findings of the pilot</p>	

<p>Land tenure</p>	<p>Issue Rural Land Proclamations to enhance land tenure security and a directive to establish appropriate land administration institutions in another emerging region (Afar)</p>	<p>Issue Rural Land Proclamations to enhance land tenure security and a directive to establish appropriate land administration institutions in two other emerging regions (Benishangul and Harari)</p> <p>Review Regional land proclamations, identify best practices, and harmonize Regional proclamations as appropriate according to emerging best practices.</p>		<p>Improved land tenure security, with more flexible and transferable rights as measured by 6 million farm households with land use certificates and long term leases for their land holdings by the end of EFY 1997</p>
<p>Vulnerability</p>	<p>Define institutional arrangements, implementation modalities and monitoring mechanism for a system of multi-annual productive safety nets and begin implementation</p> <p>Adherence to guidelines for mitigating social and environmental risks of resettlement program</p> <p>All regions conduct participatory review of implementation of resettlement program</p> <p>Food security program M&E system implemented in resettlement areas. DPPC early warning system and responsive mechanism expanded to resettlement sites</p>	<p>Begin implementation of safety net, a functioning M&E system in place within the SDPRP framework to track resources and measure impacts</p> <p>Adherence to guidelines for mitigating social and environmental risks of resettlement program</p> <p>Regions adjust implementation of resettlement program based on participatory review, in line with resources, implementation capacity available and lessons learnt.</p>	<p>Strengthening of the M&E system</p> <p>Adherence to guidelines for mitigating social and environmental risks of resettlement program</p>	<p>Differentiate public response to predictable vs. unpredictable food insecurity as measured by 3 million of predictable food insecure population benefiting from multi-annual productive safety nets including public works, conditional transfer programs, and other programs for the most vulnerable.</p> <p>Improved public response to shocks and access to consumption smoothing mechanism as measured by 6% of food security program financed from government treasury funds</p>

Nutrition	Establish a multisectoral joint coordinating structure for nutrition, including a lead coordinating agency, and initiate a multisectoral process to define a strategy on nutrition	Complete and adopt the nutrition strategy Design and implement the pilot nutrition elements of the Food security Project complemented/linked to community based outreach nutrition elements of the health extension program of the FMOH in 2 to 3 regions.		
Environment	Sectoral EIA guidelines on agriculture, industry, Dams, Mining, road and procedural guidelines completed and under implementation. Social impact assessment guideline and resettlement guideline completed. Regions to establish regional environmental protection units National workshops on implementation of EIA and pollution guidelines conducted. Awareness materials disseminated to the public.	Continue providing training and awareness creation on application of fertilizer, pesticide and other guidelines. One more region (Tigray) to develop regional environmental laws. Review progress on establishment of environmental units in sector ministries and agree on follow up actions.	Continue providing training and awareness creation on application of guidelines Two more regions/councils develop regional environmental laws (Dire Dawa and SNNP)).	Enhanced implementation and effectiveness of existing environmental policies, laws and strategies
PRIVATE SECTOR DEVELOPMENT				
<i>Theme Goal:</i>				
• Real GDP growth rate recovers from estimate of -3.8% in 2002/03 to 6.7% in 2003/04 and 6.4% in 2004/05				
<i>Overall Theme Outcomes:</i>				
• Increased factor productivity to be measured on the basis of new indicators to be developed.				
• Contribution of PSD to GDP growth as measured by <i>share of private investment in GDP increasing from 9% in 2002/03 to 13% in 2004/05</i>				
Competition	Appointment of members of the commission and establishment of competition secretariat and formulation of regulations, through consultations with the private sector	Effective implementation of the Trade Practice Proclamation as evidenced by number of staff and budget allocated; cases resolved and fines levied; 'competition advocacy', and public information programs Review of the legal framework for competition policy		Improved enforcement of competition policy to be measured on the basis of indicators to be developed during the program period

Regulatory Burden	Review of commercial registration and licensing regulations	Reduction in time required for customs processing		Reduced regulatory burden as measured by specified reductions in measures undertaken
Trade	<p>Memorandum on Foreign Trade Regime submitted to WTO</p> <p>Road Map for WTO accession prepared</p>	<p>Government staff and Private Sector representatives trained for negotiations</p>	<p>Negotiation on WTO accession started</p> <p>Two sector-studies on impact of WTO accession completed and discussed</p>	<p>Progress in WTO membership</p>
Privatization	<p>Finalization of a Privatization Action Plan and commencement of implementation of agreed measures for accelerating privatization program</p> <p>Parliamentary approval of merger between PESA and EPA</p>	<p>Privatization action plan under full implementation</p>	<p>Continued implementation of measures to accelerate privatization</p>	<p>Reduction of the role of the public sector in commercial activities as measured by public enterprise turnover as % of GDP</p>
Urban Land	<p>Revised urban land lease provision adopted in Addis Ababa; including adoption of a directive for the management and regularization of informal settlements; and regularization under implementation.</p> <p>Issuance of a draft compensation law to ensure compensation to affected parties in the event of a "taking" by government.</p> <p>Issuance of directives for and start of implementation of regularization of illegal/informal settlements in Addis Ababa.</p>	<p>Issuance of new urban land lease regulations in 2-4 Regions/city administrations; clearance by the Cabinet and submission to Parliament of compensation laws applicable in cases of acquisition of property for public purposes</p>	<p>Continued implementation of urban land policy</p>	<p>Improved efficiency of urban land lease administration as measured by reduced cost and time for acquiring leased land in Addis Ababa and, if possible, other major urban areas</p>

<p>Financial Sector</p>	<p>Review micro- and rural finance strategy and develop action plan to improve access to micro- and rural finance</p> <p>Strengthen CBE's retail lending operations for the rural sector and CBE's on lending operations for the MFIs</p>	<p>Implementation of micro- and rural finance action plan</p> <p>Finalize study for development of securities market operations</p> <p>Improve the treasury bills/ treasury bond market system</p> <p>Leasing financing is available</p> <p>As part of the Civil Service Reform Program, complete the ongoing business process re-engineering review at DBE and on basis of the outcomes prepare an action plan and start implementation (HR, top management, financing, products)</p>	<p>Satisfactory implementation of DBE restructuring plan</p>	<p>Access to finance as measured by increased number of households that are clients of MFIs and increased number of bank borrowers</p>
--------------------------------	--	---	--	--

<p>Banking Sector</p>	<p>Satisfactory implementation of CBE restructuring plan (i.e. according to planned schedule)</p> <p>Launch a study for development of securities market operations</p>	<p>Continue satisfactory implementation of CBE restructuring plan (i.e. according to planned schedule)</p> <p>Design and establish credit information bureau and initiate operation</p> <p>Offer for sale CBB, including preparation of bid documents and issuing the invitation for bids</p> <p>Upgrade of know-how and technology of public and private banks (e.g. from foreign sources, matching grants, twinning arrangements, mgmt. contracts)</p> <p>Finalize study on excess liquidity problem of banking sector. Develop an action plan based on study to address the excess liquidity problem</p> <p>Strengthen regulatory and supervisory capacity of NBE for MFIs: a) Increase the number of inspectors to 12, b) Carry out training of inspectors and finalization of inspection manual</p> <p>Set up a National Payment Council and design modern payment system</p>	<p>Continue satisfactory implementation of CBE restructuring plan (i.e. according to planned schedule)</p> <p>Complete privatization of CBB with due regard to the offer</p> <p>Actual transfer will be implemented (participation by banks is voluntary)</p> <p>Implement action plan to reduce excess liquidity</p> <p>Strengthen regulatory and supervisory capacity of NBE for MFIs: a) Increase the number of inspectors to 15, b) Carry out training of inspectors and finalization of external audit guidelines for MFIs</p> <p>Initiate operation of modern payment system</p>	<p>Increased contestability in the banking system as measured by private bank market % share of deposits (or total assets)</p> <p>Increased banking system strength and efficiency as measured by reduction of non-performing loan portfolios for CBE and DBE</p> <p>Total financing to the private sector (from credit, leasing and securities market sources) as % of GDP</p>
------------------------------	---	--	--	---

Telecommunications	Adoption of revised telecommunications policy allowing for partial liberalization of the telecommunications sector and commencement of implementation	Continued implementation of relevant actions from policy statement	Increased access to telephone and Internet service as measured by telecom density of 1.8%
HUMAN DEVELOPMENT			
<p><i>Theme Goal:</i></p> <ul style="list-style-type: none"> Increased share of healthy and educated Ethiopians enjoying an improved standard of living access to economic opportunities, especially poor people as evidenced by an increase in life expectancy from 52 in 2000/01 to 58 by 2004/05 <p><i>Overall Theme Outcomes:</i></p> <ul style="list-style-type: none"> Increased access, completion and equity in education Reduction in the Infant Mortality Rate from 113/1000 in 2002 to 100/1000 by 2004/2005 Reduction in the Maternal Mortality Rate from 871/100,000 in 2002 to 500-700/100,000 by 2004/2005 Reduction in HIV Prevalence among 15-24 year old pregnant women from 12% in 2002 to 10% by 2004/2005 			
Education sector performance	Satisfactory implementation progress as assessed in the 2004 education sector review Commencement of study/survey establishing baseline data for the textbook to student ratio, classes with more than 75 students, and learning achievement results.	Satisfactory implementation progress as assessed in the 2005 education sector review Completion of the survey and establishment of benchmark targets for textbook: pupil ratio (by core subjects) for EFY 1998 ESDP III prepared, consultations held with stakeholders, finalized, and implementation begun	Satisfactory implementation progress as assessed in the 2006 education sector review Increased Access, Completion & Equity Primary as measured by: Increased primary enrolment (Gross Enrolment Ratios –GER- of 70%); increased completion of primary education (Grade 5 completion rate of 40%); and increased Gender parity index (GPI) for grades 1-8 of 0.79;
National Learning Assessment	Analysis of Grade 4 and 8 National Learning Assessment data completed and recommendations developed based on the results of the national learning assessment	The learning assessment findings and recommendations will be used as input to ESDP III preparation	
School construction	Federal design options and guidelines for primary school construction with lower unit costs and community participation are validated and adopted by all Regions	Conduct review of implementation experience of new primary school construction guidelines.	

Health sector performance	Satisfactory implementation progress as assessed in the 2004 health sector review	Satisfactory implementation progress as assessed in the 2005 health sector review Complete health worker study and follow-up with implementation of its recommendations HSDP III prepared, consultations held with stakeholders, finalized, and implementation begun	Satisfactory implementation progress as assessed in the 2006 health sector review	Improved coverage and effectiveness of basic health services as measured by increase in EPI coverage as proportion of children receiving DPT3 vaccination to 60%; increase in proportion of deliveries attended by trained personnel to 25%; and increase in contraceptive prevalence rate to 24%
Health Extension	Implementation of health extension package including training of health extension workers	Initiate DHS Finalize and operationalize implementation guidelines for HEP and minimum health service package		
Reproductive health	Develop the reproductive health strategy	Implement action plan for reproductive health strategy		
HIV/AIDS	Initiate conduct of HIV/AIDS biological survey	Complete HIV/AIDS biological survey Formulation of guidelines for support to orphans and vulnerable children (OVC) and completion of action plan	Report findings of the HIV/AIDS biological survey	
Gender	Initialize National Action Plan on Gender	Complete the preparation of National Action Plan (NAP) on Gender and submit plan to Cabinet	NAP approved by Cabinet Funding for implementation of NAP secured and implementation begun	

Annex F: PRSCII Results Matrix

PRSC Series Outcome	Progress Indicator	Baseline	PRSC Series Targets	Performance to Date	Comments
OVERALL GOAL					
Reduction of people living in poverty	Poverty headcount	44.2% in 1999/00	40% by 2004/05	No recent data available	Data will be made available with publication of WMS/HICES results at end-2005
PUBLIC INSTITUTIONAL PERFORMANCE					
Increased resources focused on service delivery at regional level and below	Size of woreda transfers	Birr 3,068 million, or 55% of regional budget in 2002/03	--	Birr 3,547 million, or 60% of regional budget in 2003/04	Budgeted amount in 2004/05 is Birr 4,223 million, or 62% of the regional budget
Increased fiscal autonomy at regional level and below	Amount of locally raised revenues in Regions	Birr 2,105 million, or 34% of regional budget in 2002/03	--	Birr 2,357 million, or 31% of regional budget in 2003/04	Budgeted amount in 2004/05 is Birr 4,796 million, or 45% of the regional budget; figures include municipal revenue
Decreased transaction costs for business when dealing with government	Cost and time required to register a new business	Cost of new business registration was USD 425 and time required for registration was 44 days in 2001/02	--	Cost of new business registration is USD 95 and time required for registration is less than one day	--
RURAL DEVELOPMENT AND VULNERABILITY					
Growth in rural incomes	Reduction of people below the poverty line in rural areas	45.0% in 1999/00	--	No recent data available	Data will be made available with publication of WMS/HICES results at end-2005
Accelerated rural growth	Average agricultural GDP growth and crop GDP growth	3.1% average annual agricultural growth between 1991/92 and 2000/01	Average agricultural GDP growth of 12% and crop GDP growth of 14.3% between 2002/03 to 2004/05	18.9% growth in 2003/04	Much of the growth can be attributed to the rebound from the drought
Increased growth rate of off-farm income	Measure to be developed.	--	--	--	--
Increased resilience to and reduced impact of shocks	Percentage of stunted children under 5	57% in 1999/00	52% in 2004/05	No recent data available	Data will be made available with publication of WMS/HICES results at end-2005

PRSC Series Outcome	Progress Indicator	Baseline	PRSC Series Targets	Performance to Date	Comments
PRIVATE SECTOR DEVELOPMENT					
Accelerated economic growth	Real GDP growth rate	-3.8% in 2002/03	6.7% in 2003/04 and 6.4% in 2004/05	11.6% in 2003/04	Growth reflects rebound from drought year
Increased factor productivity	Measure to be developed.	--	--	--	--
Contribution of PSD to GDP growth	Share of private investment in GDP	9% in 2001/02	13% in 2004/05	10.8% in 2002/03	--
HUMAN DEVELOPMENT					
Increased share of healthy and educated Ethiopians enjoying an improved standard of living	Life expectancy	52 in 2000/01	58 by 2004/05	No recent data available	The data base to monitor these indicators is the DHS currently planned for 2005.
Increased access, completion and equity in education	Primary (1-8) Gross Enrolment Ratio (GER) (%) Grade 5-completion rate (%)	64.3% in 2002/03 --	66% in 2003/04 and 70% in 2004/05 37% in 2003/04 and 40% in 2004/05	68% in 2003/04 44% in 2003/04	Target exceeded. Target exceeded.
Improved health status, especially for poor people	Gender Parity Index (GPI) for grade 1 to 8 Infant mortality rate	0.70 in 2002/03 97/1000 in 2000/01	0.76 in 2003/04 and 0.79 in 2004/05 85/1000 by 2004/05	0.76 in 2003/04 No recent data available	Target met. Data will be made available with publication of WMS/HICES results at end-2005
Halt and begin to reverse the spread of HIV/AIDS	Maternal mortality rate HIV prevalence among 15-24 year old pregnant women	871/100,000 in 2002 12% in 2002	750/100,000 by 2004/05 10% by 2004/05	No recent data available	Data will be made available with publication of WMS/HICES results at end-2005 More reliable figures for comparison are expected from the DHS currently planned for 2005.
Sustainable access to safe drinking water and adequate sanitation facilities	% of population with access to potable water	30% in 2000	36.6% in 2003/04 and 39.9% in 2004/05	No recent data available	--

Annex G: The Investment Climate and Private Sector Development in Ethiopia

Background

1. Ethiopia is one of the poorest countries in the world. Average incomes may have been no higher at the turn of the 21st century than forty years earlier. This dismal record reflects a number of structural, exogenous, and self-inflicted factors. Geography is a major handicap. Rugged terrain makes provision of roads and other infrastructure costly, while poverty compounds the effect of geography, limiting both supply (finance for investment) and demand (market for infrastructure services). Periodic droughts have put up to 15 million people (more than 20percent of the population) at risk of starvation – compared to the “normal” number of 5-7 million chronically hungry. Recurrent external and internal conflicts have set back development efforts and damaged the investment climate. Finally, Ethiopia’s development strategy and policies have undermined growth and poverty reduction, especially the period of socialist policies under the Derg regime (1974-1991).

2. Ethiopia is extremely poorly served with infrastructure.

- *Road density* was 28 km per 1000 km² in 2002, one of the lowest in the world and little more than half the Sub-Saharan African average (50 km per 1000 km²).
- *Power*. Only 11 percent of the population have access to electricity (are close enough to a source to be connected). Many with potential access cannot afford electricity; only 6 percent of the population in 2002 were connected. Most power is from hydro sources, which has reduced reliability. On average, there are 5.5 outages per month, reducing output by over 5 percent. Connection times average 114 days.
- *Telecommunications*. As with roads and electricity, Ethiopia’s telecom density is one of the lowest in the world: 3.6 fixed phone lines per thousand in 2000 compared to 14.2 for Sub-Saharan Africa. Average waiting time for a business connection in 2002 was 204 days compared to 16 days in China and 48 days in Pakistan. Mobile phone service is available and is now expanding after a slow start.

3. External and internal conflicts have been enormously damaging to the investment climate. The war with Eritrea (1998-2000) undermined investor confidence, sidetracked reform, and diverted resources from infrastructure and other economically productive activities. Internal conflicts, especially the arrest of opposition leaders after the 2005 elections, further reduced investor confidence and antagonized several donors. Foreign investment fell from a high of \$288 million in 1997 to \$20 million in 2001 (0.2 percent of the total for Sub-Saharan Africa).¹⁶ Decentralization to ethnically-based regions also affects the investment climate, though the effects are complicated and it is difficult to know whether the net balance is positive or negative.

¹⁶ In FY05 foreign investment was \$150 million and in FY07 it was \$404 million. The Africa Region has noted that pre-implementation agreements rose sharply in 2005. It remains to be seen how many of these will become operational.

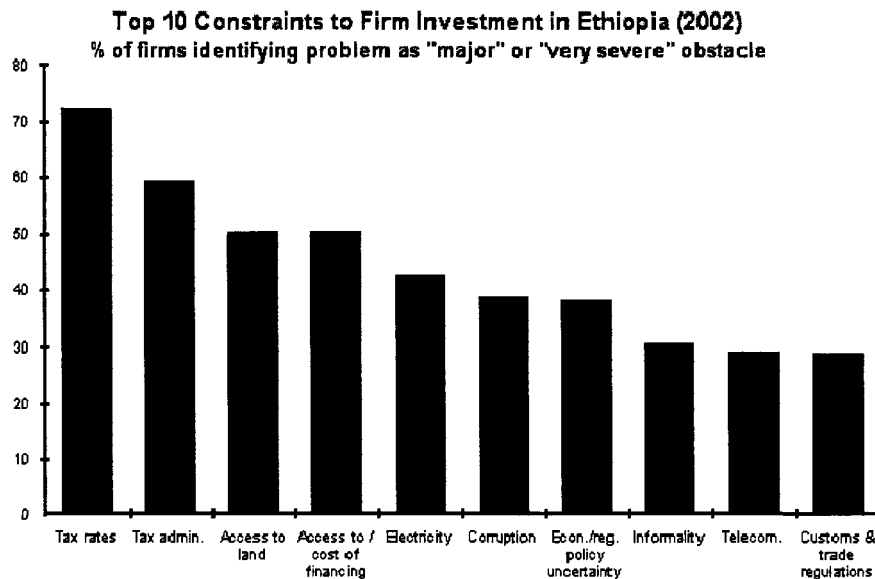
4. Many of the institutions associated with a favorable investment climate and with growth are weak – public administration (tax, customs, regulatory agencies, and judiciary), financial services, accounting and auditing. This weakness reflects low skills and a legacy from the period of socialist policies during 1974-91. After the overthrow of the Derg in 1991, the new government embarked on a program of macro stabilization and liberalization of prices, imports, and the exchange rate. A new Agricultural Development Led Industrialization (ADLI) strategy was announced. Private sector development was also encouraged, along with privatization of small scale enterprises, but the state continued to dominate large-scale activities. In banking, power, telecom, and transport, the role of the private sector remained limited. Government regulatory and other policies tend to favor state-owned enterprises. In addition, there is unfair competition from “foundation companies” (party-related firms) which have captured some business areas.

5. In fact the government has been highly ambivalent about the role of the private sector. This is reflected in statements by the Prime Minister distinguishing between the rent-seeking and the value-creating private sector that seem to imply that the dominant tendency in the Ethiopian private sector is rent-seeking. The government’s ambivalent attitude also became evident early on in slow progress on privatization and in differences between the Bank and the government on issues such as telecommunications and land policy. Ambivalence is heightened by the mixing of politics and business. The ruling party owns a number of important businesses. These “party-statal” are resented by private business because of their perceived privileges. A large section of the business community (and much of the Ethiopian Diaspora) also support the opposition parties, which contributes to ruling party suspicions of business motives.

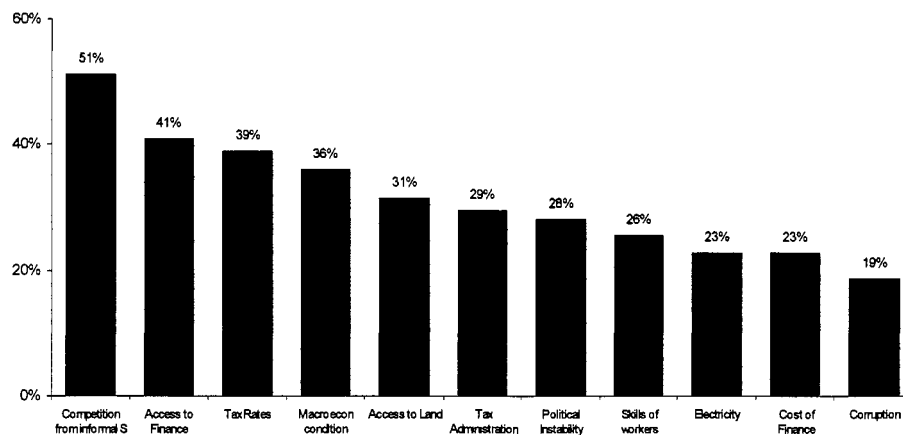
Changes in the investment climate

6. An Investment Climate Assessment (ICA) carried out in 2002 identified the obstacles perceived by Ethiopian business at that time (see Figure 1). The main obstacles were:

- *Tax rates and administration.* The most frequent complaint was that tax rates are too high and unpredictable. Tax officials visit firms periodically to assess taxes, sometimes for up to three years in the past. This is mainly presumptive taxation as many firms are unable to keep acceptable accounts, but firms complained that tax officials do not listen to their explanations. The problem is not corruption but arbitrary and unpredictable taxation.
- *Access to land.* All land in Ethiopia continues to be owned by the state. Leases ranging from 50-99 years are available with rents set by regional governments. Access to urban land constrains business operation and expansion: the supply of new leasehold land is limited; rents are high (25 percent of average sales in Addis); waiting time for allocation of plots is lengthy; and firms are unable to use land leases as collateral for credit.
- *Access to credit.* Credit access and cost (including high collateral requirements) were seen as major to very severe obstacles by many firms, especially young firms and those outside Addis Ababa. The financial system is dominated by the publicly-owned Commercial Bank of Ethiopia which has an extensive branch network but which made very few loans outside Addis in the years immediately preceding 2002.

Figure 1: Top Ten constraints to Firm Investment in Ethiopia (2002)

7. A new Investment Climate Assessment was conducted in 2006 (ICA-2006). The numbers in the two surveys are not directly comparable because of different coverage and aggregations, but ICA-2006 shows a similar set of concerns to those in ICA-2002 (see Figure 2). Access to financing has moved up the list of constraints, but taxes and access to land are still perceived as major constraints. The most striking difference is that “anti-competitive or informal practices” has emerged as the most frequently cited constraint. It is not clear what practices are included in this category. An informal note from the Region interprets this as competitive pressure from the less-regulated informal sector. “Informal enterprises extend well beyond small-scale service and retail establishments, and include small manufacturers exceeding 10 employees. This is why in an overburdened regulatory environment, it’s considered as the worst problem for those firms that are trying to operate under the legal framework, complying with the heavy regulatory regime.”

Figure 2: Main Constraints to Doing Business in Ethiopia in 2006

8. The Africa Region has provided an alternative comparison (see Figure 3) of the results of the two investment climate assessments, but it is not clear whether the samples

and questions asked are comparable for the two years. If they are comparable, then the improvement in some areas has been greater than suggested in the comparisons in Figures 1 and 2.

9. Table 1 below helps put Ethiopia's investment climate in comparative perspective. The World Bank's annual *Doing Business* report shows Ethiopia to be somewhat below average in overall ease of doing business – 102 out of 178 countries (including OECD countries) in 2007, but generally above the regional average for Sub-Saharan Africa.

Figure 3. Percent rating factor as obstacle to business operations (all industries)

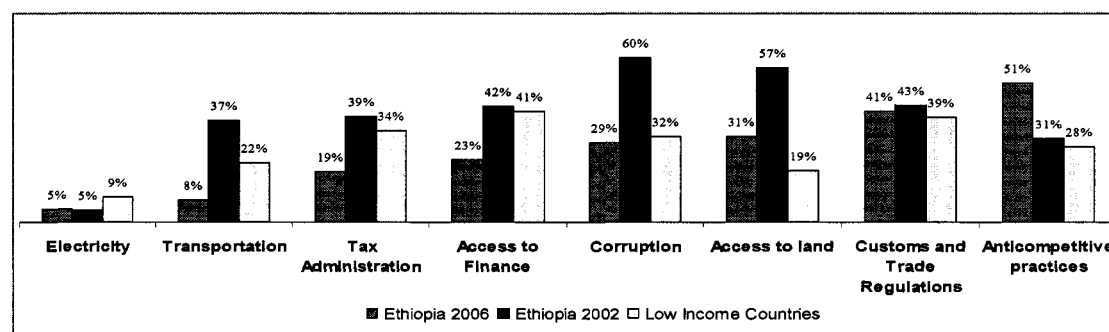


Table 1: Ethiopia: Business Regulations Benchmarks

Ease of...	Doing Business 2008 rank	Doing Business 2007 rank	Change in rank
Doing Business	102	99	-3
Starting a Business	106	103	-3
Dealing with Licenses	58	60	+2
Employing Workers	89	89	0
Registering Property	147	145	-2
Getting Credit	97	94	-3
Protecting Investors	107	105	-2
Paying Taxes	29	33	+4
Trading Across Borders	150	149	-1
Enforcing Contracts	77	77	0
Closing a Business	70	70	0

Note: Doing Business 2007

10. Overall there appears to have been little progress in PSD and the investment climate since 1998, in part because political factors have offset any modest improvements in policy. There have been improvements in the ease of business registration and licensing, customs clearance, the overall tax regime, labor regulations, and other business regulations, but there has been little apparent progress on privatization, telecommunications policy, competition policy, access to land, or access to power and water. Changes in particular aspects of investment climate and PSD are reviewed below. Progress has been mixed.

11. *Role of the private sector.* Private investment as a share of GDP has remained around 12 percent for several years (see Table 1 in main report). About 200 (mostly small) enterprises have

been privatized since 1994 but another 130 state-owned enterprises (SOEs) remain, 100 of which are to be privatized. Privatization has picked up in the past two years but remains slow.¹⁷ Key sectors – finance, telecom, power, transport, wholesale and retail distribution – are dominated or monopolized by SOEs and/or are protected from foreign investment. Direct foreign investment in Ethiopia is about 1 percent of GDP, well below the Sub-Saharan Africa average, though there has been some increase in foreign investment in roses, tourism, and construction.

12. *Competition policy* is closely related to the role of the private sector. The government has established a competition policy, including a secretariat to administer it, but the secretariat is underfunded, not autonomous, and the law itself contains too many exceptions to be useful. The government recently agreed to revise the law. The government has rejected any suggestion that policies toward party-related enterprises should be changed.

13. *Regulatory framework*. The most dramatic improvement in IC is the reduction in time and cost to register a business – from 40 days and \$400 to 16 days and \$70. This was largely achieved by the simple step of dropping a requirement to post a notice in the newspaper of intent to register. The time taken to clear customs for imports and exports has also been reduced and hiring and firing regulations for labor have been reduced. Regulation of ongoing business operations remains cumbersome.

14. *Tax regime*. The presumptive tax regime affecting smaller firms has been substantially reformed to make it less arbitrary. Interviews with local firms confirmed that an improvement has taken place. The introduction of a VAT has complicated operations for SMEs, however.

15. *Access to land* remains a major constraint on business expansion. Leases are costly, registration is slow, leased land cannot be used as collateral for loans, and disputes over leasehold rights are common.

16. *Access to finance* also remains a major problem for all but the largest businesses. The financial sector is weak and uncompetitive. Non-performing loans have been reduced (from around 50 percent) but remain at about 20 percent. Domestic private banks are allowed, but foreign banks are not, and the state-owned Commercial Bank of Ethiopia still dominates the banking sector (75 percent of market share).

17. *Infrastructure*. Road density has increased from a very low level (27 km per 1000 km² in 2000/01 to 30.8 in 2003/04), but is still well below the African average. The core functions of the telecom sector are a government monopoly but some peripheral activities are open to the private sector and mobile phone access has been expanding rapidly. Costs to business remain very high. Access to water and power remains problematic.

17. The Africa Region has commented (emphasis in original): “In March 2006, the Bank’s supervision mission for the PSD Capacity building project concluded that the *pace of enterprise divestiture was consistent with agreements between the Government and World Bank* at the outset of the project. PPESA made commendable progress over the six months prior to March 2006, during which 18 divestitures had been concluded; 8 by direct sales, 3 by restitutions and 7 through public-private partnerships. Tenders for 8 companies had to be closed by March 9, 2006 which would introduce another active list for completion by end June 2006. In 2007, the rate of privatization increased even more quickly.”

18. *Trade policy* has improved somewhat since 2005. Ethiopia has submitted a Memorandum of Foreign Trade to the WTO after a long delay. The weighted average tariff rate dropped from 19.5 percent to 17.5 percent, export taxes have been abolished, and a duty drawback system has been put in place. Export and import clearance procedures have improved, but Ethiopia still ranks very low (150 out of 178 countries) on trade facilitation.

19. *Governance.* Table 2 shows governance indicators from both external organizations (International Country Risk Guide and Transparency International) and the World Bank (CPIA ratings and WBI Governance Indicators). Despite big differences in definitions and methodology, the sources show that Ethiopia generally ranks poorly compared to other countries (in the lowest quartile of countries on many indicators) and that most indicators have declined since 1999 or 2000.

Table 2a: Ethiopian Governance Indicators

Ethiopia ICRG Governance Ratings and Country Ranking (out of 140 countries)												
	Bureaucracy Quality (0-4)			Corruption (0-6)			Democratic accountability (0-6)					
Country	Rank	1990	1999	2005	Rank	1990	1999	2005	Rank	1990	1999	2005
Ethiopia	109	0.0	1.0	1.0	81.0	3.0	2.0	2.0	78.0	2.0	4.0	4.0

Source: International Country Risk Guide (ICRG) website

Table 2b: Ethiopia- Transparency International CPI Rating (out of 156 countries)

Country	Rank	2000	2001	2002	2003	2004	2005
Ethiopia	136	3.2	1.0	3.5	2.5	2.3	2.2

Source: Transparency International

The CPI ranges between 10 (highly clean) and 0 (highly corrupt)

Table 2c: Ethiopia - World Bank CPIA Ratings (out of 134 Countries)

Property Rights & Rule Based Govern.			Quality of Budget & Finan. Mgmt.			Effic. Of revenue Mobili.			Quality of Public Admin			Transp. Account & Corrupt in Public Serc		Overall CPIA			
Rank	1999	2005	Rank	1999	2005	Rank	1999	2005	Rank	1999	2005	Rank	1999	2005	Rank	1999	2005
103	2.5	2.5	54	4	3.5	32	3.5	4.0	74	4.0	3.0	106	4.0	2.5		3.5	6.4

Source: WB Country policy and institutional Assessment (SPIA). Ratings are not for public disclosure, except 2005 ratings for IDA countries Range 1 (worst) – 6 (best)

Table 2d: Ethiopia – World Bank Institute Governance Indicators (out of 210 countries)

Voice and Accountability			Political stability			Government Effectiveness			Regulatory Quality			Rule of Law			Control of Corruption		
Rank	2000	2005	Rank	2000	2005	Rank	2000	2005	Rank	2000	2005	Rank	2000	2005	Rank	2000	2005
168	-1.06	-1.1	196	-1.27	-1.48	177	-0.46	-0.97	175	-0.69	-1.09	150	-0.47	-0.77	153	-0.01	-0.79

Source: World Bank Governance indicators 1996- 2005.

The six governance indicators are measured in units ranging from about -2.5 to 2.5, with higher values corresponding to better governance outcomes.

20. *Institutional development.* Tax administration, customs, the Ethiopian Investment Commission, and the privatization agency have all shown modest progress in institutional development. But there has been less success in the development of financial institutions, the judicial system, land administration, and competition regulation. A scorecard approach suggests that institutional development was modest with respect to IC and PSD.

21. But stepping back to look at the broader picture, it is unclear whether on balance Ethiopia has experienced institutional development or institutional decay. Decline in governance indicators reflects a general failure to build independent institutions capable of withstanding political interference or state capture. Patronage in public administration and politicization of the bureaucracy have reportedly risen since 2005. The line between party and state is indistinct, particularly at the woreda level. Failure to strengthen institutional checks and balances has hurt the investment climate and limited prospects for robust private sector development.

