



# Program Information Document (PID)

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Concept Stage | Date Prepared/Updated: 10-Sep-2018 | Report No: PIDC25386



**BASIC INFORMATION**

**A. Basic Project Data**

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

**Proposed Development Objective(s)**

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

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

**SUMMARY**

<b>Total Financing</b>	1,000.00
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**DETAILS**

<b>Total World Bank Group Financing</b>	1,000.00
World Bank Lending	1,000.00

**Decision**

The review did authorize the preparation to continue



## B. Introduction and Context

### Country Context

Ethiopia, a growing economy with a population of over 100 million located in the conflict-affected Horn of Africa region, is experiencing an unprecedented process of political and economic change. A new Prime Minister came to power in April 2018, during one of Ethiopia's worst political and social crises in decades, which had forced the government to declare a state of emergency twice in three years. Since his appointment, the Prime Minister has taken bold steps to restore peace with Eritrea following two decades of conflict, and his administration has opened new political space for dialogue, released political prisoners, lifted bans on political parties and media outlets, actively engaged in regional diplomacy, and announced a range of economic reforms designed to revitalize the Ethiopian economy by strengthening the role of the private sector.

For the last 10 years, the Ethiopian economy has grown at an annual rate of over 10 percent in real terms, making Ethiopia one of the world's fastest-growing economies. This period of robust growth was driven by large-scale public investment, which in turn was made possible by favorable commodity prices and international debt-relief efforts in the mid-2000s. The poverty rate declined from 55.5 percent in 2000 to 26.7 percent in 2016, and Ethiopia made significant progress on the Millennium Development Goals (MDGs). The primary enrollment rate quadrupled, the child mortality rate halved, and the number of people with access to clean water more than doubled. In addition, the average life expectancy has increased by about one year annually since 2000 and is now higher than the averages for both Sub-Saharan Africa (SSA) and low-income countries worldwide. However, Ethiopia continues to face serious development challenges, especially in public health, education, and gender equity. Maternal and child mortality rates remain high, as does the rate of stunting and malnutrition. Access to education has increased, but only 57 percent of children starting first grade will complete ninth grade. Learning outcomes are improving, albeit from a low base, and the quality of education requires further improvement. In addition, Ethiopia hosts more than 920,000 refugees, primarily from neighboring Somalia, Sudan, South Sudan, and Eritrea, and the number of internally displaced people (IDPs) has risen from 1.6 million to 2.8 million since the beginning of this year. While Ethiopia remains one of the most equal country in the world, with a Gini coefficient of 0.33 in 2015, gender disparities are profound, and a combination of cultural norms and socioeconomic inequality greatly increases the risks faced by women.

Ethiopia's growth has been driven by public investment and agricultural growth. The Government has sustained high levels of public investment which has driven strong growth in agriculture and services. This has been financed by tapping external financing, keeping government consumption low and heterodox mechanisms including financial repression that kept interest rates low and directed credit to public infrastructure, an overvalued exchange rate that cheapened public capital imports, and direct central bank financing of the budget. However, Ethiopia's recent economic success has occurred in a context of modest structural economic transformation and private-sector development and growing macroeconomic vulnerability, which could threaten the long-term sustainability of its growth model.<sup>1</sup> There has been relatively slow progress in the development of a vibrant private sector especially in manufacturing and modern services, growing indebtedness and persistent inflation. As the GTP II nears its midpoint, the government is shifting its focus to private-sector participation in an effort to enhance economic dynamism.

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<sup>1</sup> World Bank. 2016. *Ethiopia's Great Run: The Growth Acceleration and How to Pace It*. Washington, DC: World Bank Group



#### Relationship to CPF

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

This DPO with the focus on creating fiscal space, opening up private sector and improving accountability and transparency complements actions already supported through the WBG operations in Ethiopia on social and economic inclusion agenda, human capital development and resilience.

#### **C. Proposed Development Objective(s)**

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

#### Key Results

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

#### **D. Concept Description**

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



The government's current model for financing infrastructure investment cannot be sustained indefinitely. In Ethiopia's financial sector, the government rations domestic credit between competing uses. Recent policies directing the bulk of domestic bank credit to publicly provided infrastructure and basic services greatly increased the public capital stock, but also led to the rapid accumulation of public external debt. To sustain high growth rates, Ethiopia needs to identify sustainable ways to finance infrastructure. This can be achieved by (i) mobilizing private investments through PPP; (ii) reforming the power sector to prepare for more private participation and competition; (iii) reforming the logistics sector to reduce costs and improve efficiency; and (iv) reforming the telecom sector to improve connectivity and prepare for more private sector participation and competition.

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

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

## **E. Poverty and Social Impacts and Environmental Aspects**

### Poverty and Social Impacts

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

### Environmental Impacts

From an environmental perspective, the proposed policy actions can be grouped into those that may likely cause downstream environmental effects; those that likely have little direct effect (but provide an opportunity to ensure that the overall regulatory approach pays sufficient attention to environmental planning, protection and compliance); and those related to transparency and accountability. Increased information disclosure is likely to have positive social effects, and indirect positive environmental effects through improvement of policies and participation. In fact, there is room to explore strengthening these measures to improve environmental outcomes through information dissemination,



awareness raising and public participation. The policy actions most likely to cause downstream environmental effects include: (i) promoting Public Private Partnerships; (ii) promoting private sector investments in renewable energy; (iii) streamlining business registration; and (iv) facilitating Foreign Direct Investment. This assessment is related to Ethiopia's weak institutional capacity to manage and control potentially negative effects of investment projects, in particular the weak system for conducting EIAs and enforcing compliance with the results.

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**APPROVAL**

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**Approved By**

Country Director:	Nicole Klingen	10-Sep-2018
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