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Report No: 30758-ET

PROJECT APPRAISAL DOCUMENT

ON A

PROPOSED CREDIT

IN THE AMOUNT OF SDR 12.7 MILLION
(US$19 MILLION EQUIVALENT)

AND A

PROPOSED GRANT

IN THE AMOUNT OF SDR 3.4 MILLION
(US$5 MILLION EQUIVALENT)

TO THE

FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

FOR A

PRIVATE SECTOR DEVELOPMENT CAPACITY BUILDING PROJECT

November 23, 2004

Private Sector Development Unit
Africa Region

CURRENCY EQUIVALENTS

(Exchange Rate Effective October 12, 2004)

Currency Unit	=	Ethiopian Birr (ETB)
8.6 ETB	=	US$1
US$1.4675	=	SDR 1

GOVERNMENT FISCAL YEAR

July 8 – July 7

ABBREVIATIONS AND ACRONYMS

AAU	Addis Ababa University
ADB	African Development Bank
AGOA	African Growth and Opportunity Act
ASCAP	Matching Grant for Associations and Chambers
ASPEN	Africa Safeguards Policy Enhancement
APL	Adaptable Program Credit
BDS	Business Development Services
BIZCAP	Matching Grant Scheme comprising FIRMCAP and ASCAP
BIZPLAN	Business Plan Competition
CAS	Country Assistance Strategy
CB	Capacity Building
CBDSD	Capacity Building Project for Decentralized Service Project
CEM	Country Economic Memorandum
CFAA	Country Financial Accountability Assessment
COMESA	Common Market for Eastern and Southern Africa
CSA	Central Statistical Authority
DAG	Development Assistant Group
DTIS	Diagnostic Trade Integration Study
EAL	Ethiopian Airline
EEPCO	Ethiopia Electricity and Power Company
EDRI	Ethiopian Development and Research Institute
EMCP	Expenditure Management and Control Program
EPA	Ethiopia Privatization Agency
EPA	Economic Partnership Agreement
ERC	Ethiopia Railway Corporation
ERR	Economic Rate of Return
ETC	Ethiopia Telecommunication Company
EU	European Union
FBE	Faculty of Business and Economics
FDI	Foreign Direct Investment
FIRMCAP	Firm Capacity Building through MGS
FMRs	Financial Monitoring Reports
FMS	Financial Management Systems
FPSI	Finance, Private and Infrastructure
GBSN	Global Business School Network
GOE	Government of Ethiopia
GTZ	German Technical Corporation
ICA	Investment Climate Assessment

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ICB	International Competitive Bidding
ICTAD	Information Communication and Technology Development
IFC	International Finance Corporation
MDGs	Millennium Development Goals
M&E	Monitoring and Evaluation
MGS	Matching Grant Scheme
MFIs	Micro Finance Institutions
MOFED	Ministry of Finance and Economic Development
MOTI	Ministry of Trade and Industry
MSEDP	Micro and Small Enterprise Development Program
NBE	National Bank of Ethiopia
NCB	National Competitive Bidding
NPV	Net Present Value
OED	Operations Evaluation Department
PEs	Public Enterprises
POM	Project Operational Manual
PCU	Project Coordination Unit
PHRD	Japan Policy and Human Resources Development Fund
PMU	Project Management Unit
POM	Project Operation Manual
PPCF	Public Private Consultation Forum
PPESA	Privatization and Public Enterprise Supervisory Authority
PRSCs	Poverty Reduction Support Credits
PSD	Private Sector Development
PSD CB	PSD Capacity Building
PSR	Project Status Report
SA	Special Account
SBD	Standard Bidding Documents
SCHOOLCAP	School Capacity Building Sub-Component
SDPRP	Sustainable Development and Poverty Reduction Program
SIL	Specific Investment Loan
SMEs	Small And Medium Enterprises
SOEs	Statements of Expenditures
SPOP	Statement of Policies and Operating Procedure
TPP	Trade Practices Proclamation
UK DFID	UK Department for International Development
UNCTAD	United Nations Conference on Trade and Development
UNDP	Development United Nations Development Program
USAID	U.S. Agency for International
WBI	World Bank Institute
WTO	World Trade Organization

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PROJECT APPRAISAL DOCUMENT

Africa Regional Office
AFTPS

Date: November 23, 2004	Team Leader: Agata E. Pawlowska
Country Director: Ishac Diwan	Sectors: General industry and trade sector (100%)
Sector Director: Michel Wormser	
Sector Manager: Demba Ba	Themes: Other financial and private sector development (P)
Project ID: P050272	Environmental screening category: Not Required
Lending Instrument: Specific Investment Loan	Safeguard screening category:

Project Financing Data

[ ] Loan [X] Credit [X] Grant [ ] Guarantee [ ] Other:

For Loans/Credits/Others:
SDR 3.4 million (US$ 5 equivalent) Grant
SDR 12.7 million (US$ 19 equivalent) Credit
Total Bank financing: SDR {16.1} million (US$ 24 equivalent)
Proposed terms: Standard with 40 years maturity

Financing Plan (US$m)

Source	Local	Foreign	Total
BORROWER	3.00	0.00	3.00
IDA CREDIT	1.97	17.03	19.00
IDA GRANT	-	5.00	5.00
OTHER PRIVATE COMMERCIAL SOURCES	15.31	-	15.31
Total:	20.28	22.03	42.31

Borrower:
Ministry of Finance and Economic Development
1905
Addis Ababa
Ethiopia
Tel: 22-66-98 Fax: 55-13-55

Responsible Agency:
Ministry of Trade and Industry
P.O. Box 704
Addis Ababa
Ethiopia
Tel: 51-80-25 Fax: 51-42-88

Estimated Disbursements (Bank FY/US$m)						
FY (US$ m)	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
Annual	2.5	2.5	5.3	4.7	4.7	4.1
Cumulative	2.5	5.0	10.4	15.1	19.9	24.0

Project implementation period: five years
Expected Effectiveness Date: March 30, 2005
Expected Closing Date: June 30, 2011

Does the project depart from the CAS in content or other significant respects? ***Ref. PAD A.3***	[ ]Yes [X] No
Does the project require any exceptions from Bank policies? ***Ref. PAD D.7***	[ ]Yes [X] No
Have these been approved by Bank management?	[ ]Yes [ ] No
Is approval for any policy exception sought from the Board?	[ ]Yes [X] No
Does the project include any critical risks rated "substantial" or "high"? ***Ref. PAD C.5***	[ ]Yes [X] No
Does the project meet the Regional criteria for readiness for implementation? ***Ref. PAD D.7***	[X]Yes [ ] No

Project development objective ***Ref. PAD B.2, Technical Annex 3***
The key objective of the project is to facilitate increased participation of the private sector in the economy by creating conditions for improving its productivity and competitiveness. This goal will be achieved by helping accelerate the process of divestiture of public enterprises and facilitating increased private participation; improving the business environment and increasing competition and the contestability of markets; strengthening the linkages and integration of the Ethiopian economy into the global markets; strengthening support for technical and business management skills and thus improving the productivity at the firm level.

Project description *[one-sentence summary of each component]* ***Ref. PAD B.3.a, Technical Annex 4***
Component One - Accelerating the Implementation of Privatization Program. This component will assist the Government in accelerating the implementation of its Privatization Program of commercial public enterprises.

Component Two - Improving the Business Environment through Implementation of Competition Policy and Accession to the WTO . This component aims at assisting the Government in the effective implementation of its competition policy, preparation for WTO accession negotiations, and long-term capacity building for the formulation and implementation of trade and competition policy. The ultimate objectives are to maintain and encourage competition, strengthen integration in the world economy, increase economic efficiency and competitiveness, and promote consumer welfare.

Component Three - Strengthening the International Competitiveness of the Private Sector and the Capacities of its Representative Organizations. .This component will help strengthen human and institutional capacity of the private sector firms, chambers network and business and professional associations.

Which safeguard policies are triggered, if any? ***Ref. PAD D.6, Technical Annex 10***

Environmental Category: B (Partial Assessment)
In Ethiopia, many of the 126 privatization candidates, particularly in certain industries, may leave behind significant environmental risks or have already caused serious impact from their production and waste handling practices. The project recognized these facts and during preparation an environmental pre-audit was undertaken that: (i) measured the environmental and social conditions, for both past and on-going activities, of the selected enterprises against the risk of being held responsible for damage; (ii) determined the need for remedial actions necessary to bring a given enterprise into compliance with national and Bank safeguard policies prior to privatization; and (iii) formulated recommendations for partial and full audits for each facility or site, as applicable, and suggested a framework for subsequent audits.

As a result of this study, 24 PEs will require full environmental audits (EAs) and remediation plans; 72 PEs will require partial audits; 44 will require no audits (see Annex 10). The approach adopted has been to agree with the Government on a specific set of guidelines for conducting EA but to defer conducting the EAs as part of the transaction process for these PEs and prior to their divestiture, with funding provided by the project. The list of privatization candidates for which environmental audits would be undertaken was agreed and is included in Annex 10. When such audits are undertaken as part of privatization transaction, they will be reviewed and cleared by IDA.

The Environmental Pre-audit has also assessed the institutional and legislative support for conducting environmental audits as well as for monitoring and enforcement of environmental management in Ethiopia. The Federal Environmental Protection Authority (FEPA) has the responsibility for overall management of Ethiopia's environment. The Authority has been continuously improving the environmental management initiatives since its inception in 1995, however, work is still required to develop and refine the specific EHS guidelines and regulations to accommodate the different sectors; methodologies for monitoring waste and toxic products in industrial effluents; standards for monitoring environmental parameters. The institutional set-up of the FEPA should also be strengthened to enable it to conduct high quality EAs and adequately monitor and enforce adherence to the national environmental standards and regulations. Recognizing these needs, the project will provide funding for strengthening of capacities of the FEPA.

Significant, non-standard conditions, **if any**: ***Ref. PAD C.7***
The project does not require any exception from Bank policies. Assessments and preparation of fiduciary arrangements, staff and consultant selection, monitoring and evaluation systems and implementation and procurement plans meet the regional criteria for readiness of implementation.

Board presentation:
21 December, 2004

Loan/credit effectiveness: March 30, 2005

Effectiveness Conditions:

(i) The Borrower has adopted the Project Operational Manual, including a project implementation plan and a manual of administrative, financial and accounting procedures, satisfactory to IDA.

(ii) The Borrower has established a PCU with key qualified personnel satisfactory to IDA.

(iii) The Borrower has opened a Project Account at the National Bank of Ethiopia and has made an initial deposit.

Covenants applicable to project implementation:

Disbursement Conditions:

(i) Disbursement of funds for retrenchment financing is conditional on the Borrower's furnishing to IDA a retrenchment program design and disbursement mechanism, satisfactory in form and substance to the Association.

(ii) The Borrower has adopted the Operations Manual for the Matching Grant Scheme under BIZCAP and an international expert satisfactory to IDA has been selected prior to disbursement for BIZCAP.

Other Covenants:

(i) The Borrower has recruited an external auditor, as directed by the Federal Auditor General, in form and substance satisfactory to IDA, to conduct the audit of the project financial transactions, including audit of payments of retrenchment accounts.

(ii) The Borrower has established a Public-Private Steering Committee within six months of project effectiveness. The Borrower will maintain the PCU under the Steering Committee during the life of the project.

(iii) The Borrower to conduct, in collaboration with IDA, mid-term review by June 2007.

A. STRATEGIC CONTEXT AND RATIONALE

1. Country and sector issues

Country Background

In 1992, the Government of Ethiopia (GOE) embarked on a comprehensive reform program to bring an end to economic stagnation inherited from the Derg government. The momentum of the reforms, however, was interrupted by an outbreak of the conflict with Eritrea in May 1998, which lasted until end-2000. After the war, the Government resumed its economic reform program and reconfirmed its commitment to poverty reduction through rapid, yet equitable, economic growth within a framework of macroeconomic stability and a positive social impact. The principles of the program were detailed in a Sustainable Development and Poverty Reduction Program (SDPRP) prepared by the Government in July 2002 through a process of extensive consultations with the private sector and civil society under the umbrella of Public Private Consultative Forum (PPCF) established three years ago.

The need for reforms to stimulate private sector development (PSD) to facilitate poverty reduction through growth and employment has been further elaborated in the Industrial Development Strategy (2002), which outlines the Government's key objectives and a strategy to achieve them. The objectives are to increase the contribution of private sector to the economy as measured by private investment in GDP and to increase factor productivity. This is to be achieved through a comprehensive package of reforms which would be implemented in a gradual manner over the medium- to long-term. The reforms include a wide range of measures aiming to improve the investment climate (including privatization), trade policy, reduce the regulatory burden (including tax policy and administration), and improve access to infrastructure (telecommunication, power and transport), land and finance.

The importance of these areas has been recently underlined in the "World Development Report 2005: A Better Investment Climate For Everyone," which demonstrates linkages between a good investment climate, economic growth and poverty reduction. A good investment climate encourages firms to invest by removing unjustified costs, risks and barriers to competition. Further, it encourages firms to achieve higher productivity by providing opportunities and incentives to adopt better ways of doing things, i.e., to innovate and introduce improved production, distribution and marketing processes. Governments influence the investment climate through the impact of their policies and behavior on the following factors:

(i) Costs of doing business (in terms of time and money), including contract enforcement, infrastructure services, crime, corruption and tax policy.
(ii) Risks, stemming from policy uncertainty, macroeconomic instability and arbitrary regulation.
(iii) Degree of competition through regulation of market entry and exit and response to anticompetitive behavior by firms.

The report on "Doing Business in 2005. Removing Obstacles to Growth" provides seven indicators, that outline the principles of good regulation and enable the Governments to measure their performance in achieving the above objectives through shaping the investment climate. These indicators relate to the starting and closing of businesses, registering property, enforcing contracts, hiring and firing workers, protecting investors and access to finance.

Over the past two years, the Government of Ethiopia has begun to take measures to address the investment climate issues in key areas to stimulate PSD, with some degree of success. In 2004 the Economic Freedom Index, published annually by the Heritage Foundation, noted that Ethiopia had the second-most improved business environment in the world. According to the results of the recent update of the Investment Climate Assessment (ICA, 2004) the private sector confirmed that the GOE has significantly reduced the cost of doing business by simplifying regulations and improving the quality and effectiveness of the institutions supporting the private sector – the time required to clear customs for export has been reduced; tax management and availability of land for business and industry in urban areas has been improved; access and reliability of telecommunication services was improved; and the cost and time required to register and license a business have been substantially lowered.[1] In the area of public-private consultative mechanism, several sector-specific meetings (leather, textiles and garments and horticulture) between the public and the private sector representatives took place under the framework of the PPCF to discuss policy and implementation issues.

In addition, Government took important steps in improving access to and quality of physical infrastructure. Since 2003 important gains have been achieved in network expansion and corporate reform within the monopoly Ethiopia Telecommunications Corporation (ETC). New investments have led to an increase in teledensity from 0.6 lines per 100 inhabitants in 2002 to 0.95 in 2004 and ETC plans to raise teledensity to about 1.7 in 2005. In power, the Government is driving an ambitious agenda to expand access from about 13 percent today to 20 percent in 2012 through developing the country's substantial hydropower resources, creating a policy environment conducive to private investors, strengthen the regulatory agency, and implementation of rural electrification program. In the transport sector, since 1993 the Government has invested massively in roads, devoting 20 percent of the public investment program to the sector. The Road Sector Development Program, initiated in 1997, introduced a series of policy and institutional reforms and rehabilitated critical roads identified as impediments to the Economic Recovery Program. The first phase of the Road Sector Development Program (1997–2002) resulted in significant achievements, albeit starting from a very low base. The second phase of the Program (2002–2007) aims to shift the focus from rehabilitation to development and aims to increase road density to 34 kilometers per 1,000 square kilometers.

Increasing access to finance through creating the conditions for banks to lend to private firms, as well as to households seeking mortgage finance and rural farmers, is top priority for the Government's PSD program. The agenda includes strengthening the credit environment and broadening access to financial services; reducing the existing debt overhang of the banking system while preserving viable firms; increasing the efficiency of the banking sector through measures to improve contestability; introducing new financial products, such as rural credit, credit to small and medium enterprises (SMEs), and leasing; and finding ways to establish long-term finance and equity finance markets.

Despite these positive developments, important constraints to the growth of Ethiopian business remain. While the results of the initial phase of the reforms have been very encouraging, Ethiopia is still in transition from a system in which the state was heavily involved in almost all production and distribution activities. Thus, it will take time to implement the first-generation reforms necessary to remove the main bottlenecks to PSD and to create pre-conditions for growth. There is a commitment from the Government to continue the implementation of the reforms and recognition that the action plan should be selective but also take into account the need for a multifaceted approach to PSD. Therefore, actions are required on several fronts:

(i) The investment climate - further improve and simplify tax regime; improve access to land, utilities (electricity, water) and credit; and the quality of public services (at federal and/or municipal level), all of which contribute to the costs of doing business.

(ii) Increase the pace of implementation of the PSD reform agenda, which would contribute to lowering investor perception of risk.

[1] One sign of improvement is the sharp rise in investment licenses during 2003.

(iii) Create an environment that adequately promotes improvements in firms' skills and productivity.

In addition to efforts to sustain the development of the private sector, efforts to ignite it will be needed. Ethiopia has already achieved considerable success, especially in establishing macroeconomic stability and creating a reasonable regulatory system. In the absence of efforts to nurture the private sector, these measures will yield only modest results. The industrial strategy requires measures to ignite as well as sustain the private sector. In terms of nurturing the private sector, two main policy areas are key in Ethiopia. The first is innovation. Ethiopian entrepreneurs are hesitant to go into nontraditional areas of production, which they perceive as too risky, typically investing instead in activities with low risks and low returns. If Ethiopia is to become competitive, policymakers need to identify and address the factors that lead to underinvestment in more profitable activities. The second broad policy area is the dominance of state-owned enterprises in the economy. The potential dynamism, productivity, and efficiency gains from increased private sector participation in the economy need to be realized by nurturing emerging entrepreneurs. This can be achieved by creating an environment that nurtures the private sector and increases its participation in industry (particularly manufacturing) and services, through promoting competitive processes and accelerating the ongoing liberalization and privatization processes

The donor community, of which the World Bank is one of the key players, is assisting GOE in implementing the critical mass of reforms and achieving its objectives of poverty reduction and economic growth, through a number of sector-specific as well as cross-sectoral operations. The key multi-donor instrument facilitating the policy dialog with the Government is a series of Poverty Reduction Strategy Credits, which provide budget support to assist in the implementation of SDPRP. In the PSD areas, the World Bank's support includes programs aiming to address high costs of doing business, through improvements in access and availability of land and infrastructure (especially transport, energy, ICT and water), support to decentralization and improvements in quality of public sector services (such as entry/exit regulations, taxation, customs services).[2]

The proposed PSD Capacity Building (PSD CB) project will help the Government to introduce measures aiming to nurture and cultivate the private sector development, in addition to liberalization and privatization. The project is consistent with the overall GOE strategy and its efforts to remove the key remaining obstacles to PSD and support a faster private-sector led economic growth. The project will provide financial support and technical assistance necessary for the Government to put in place key PSD policy reforms agreed under the framework of PRSC and to implement the first-generation of PSD reforms. It will address constraints related to competition, public sector dominance and low level of skills and productivity by:

(i) Helping to accelerate the process of divestiture of public enterprises;
(ii) Improving the business environment through increasing competition and the contestability of markets and strengthening the linkages and integration of the Ethiopian economy into the global markets;
(iii) Improving access to finance; and
(iv) Strengthening support for technical and business management skills, thereby improving the productivity at the firm level.

Project activities complement those of ongoing programs being carried out with support from the Bank and other donors. Due to the programmatic nature of the PRSCs and long-term nature of the PSD agenda, the PSD CB project should be seen as the first in the series of operations supporting the Government in achieving its development objectives.

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[2] Annex 2 details major PSD related projects funded by the World Bank and other donor agencies.

Sector Specific Issues

PSD constraints in Ethiopia are generally well documented as a number of analytical studies have been undertaken recently to determine their nature and scope.[3] According to the results of the recently completed ICA update (August 2004) as well as the Economic Freedom Index, published annually by the Heritage Foundation, over the past two years the investment climate has improved and some of the key constraints have been (or are being) addressed, as discussed above. Nonetheless, many of the constraints that negatively affect productivity of the private sector and its ability to compete domestically as well as regionally and thus contribute to the slow growth of the Ethiopian private sector, remain to be addressed. Many of them are structural - such as high transport costs and low domestic demand. Many of them are being currently tackled by the Government, but it will take time for the effects to be realized – such as the reforms of the tax regime; improving access, reliability and prices of utilities; and improving access to credit, most notably through securing land as collateral. Finally, there are constraints that relate to policies and institutions that impede private sector, despite its high potential for growth and diversification, and notwithstanding the Government's efforts:

(i) Dominant public sector, lack of effective competition and level playing field resulting in curbing private sector growth in terms of number and size of firms, which are small compared to the country's size and international standards.[4]

(ii) Weak integration of Ethiopian economy into the regional and international economy, which is reflected in the low level of exports – almost all Ethiopian firms are producing for the domestic market and only a few firms participate in export activities or have managed to attract foreign capital.

(iii) Low labor productivity and thus a limited capacity of the private sector to compete, and weak institutional support for the private sector. While the cost of labor is very low, compared to some leading countries exporting labor-intensive manufactures,[5] a typical worker in Ethiopia is 80 percent less productive than the average worker in Bangladesh and less than half as productive as the average Chinese worker.

The PSD CB project will help address the above constraints that relate to policies and institutions by providing technical and financial assistance aiming to reduce the role of the Government, improve the business climate, support stronger integration of the Ethiopian economy into the regional and international markets and increase labor productivity of the private sector

Public sector dominance

The public sector is large in Ethiopia and it has been the fastest growing sector in the 1990s, particularly since 1997 (CEM). During a decade of 1993-2003, the administration (including defense sector) expanded by almost 9 percent per year and its share in total GDP now reaches 12.7 percent. Although industrial growth has accelerated by 5.1 percent, industry accounts for only 10.9 percent of GDP. Total Government expenditures in 2003, accounted for around 37 percent of GDP - excluding public enterprises (PEs). Over the last five years, public investment, including PEs, has accounted for around 55 percent of total capital formation on average.

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[3] Among them are: (i) ICA, 2002; (ii) DTIS, 2003; (iii) CEM, draft in 2004; (iv) EDRI survey MSMEs of 2004.
[4] According to ICA results (2002), median surveyed firm hired only 14 employees compared to 251, 20, and 210 for China, Kenya, and Bangladesh, respectively.
[5] A median manufacturing wage rate is almost 30 percent that in China and about 40 percent lower than that in Bangladesh.

In the services area, all the utilities are state monopolies; the banking and insurance sectors are dominated by the state monopolies or are under extended public control. As expected, public administration constitutes by far the largest single component of the services - public activity accounts for more than half of output and half of value-added. Overall, the service sector (including trade, public administration, transport and communications) accounts for more than two-thirds of total sectoral output. They also jointly generate 60 percent of the sector's value-added.

The participation of the private sector in manufacturing, which is considered by the Government as an important source of economic growth outside of agriculture, has been steadily increasing over the past few years. Nonetheless, the sector is still dominated by PEs that account for 72 percent of total manufacturing value added, 62 percent of gross value of production, employ 57 percent of the manufacturing workforce and account for 64 percent of wages and salaries.[6] Public firms account for around 10 percent of the country's value-added in the industrial and service sectors. PEs are also key players in the production of industrial commodities, where they account for 41 percent of the production of agro-industrial products and around 20 percent of the production of 'other industrial products'.

The GOE has recognized that increased level of private participation would be crucial for sustained growth. Public investment has a key role to play in Ethiopia, but complementarities with private capital formation are crucial if the initial government-financed push is to be sustainable. Consequently, one of the key components of the reform efforts included transformation of the structure of the economy to be more private-sector driven through PE sector reform. The Government placed PEs under hard-budget constraints, and in 1994 started implementing a Privatization Program by establishing the Ethiopia Privatization Agency (EPA) and the sale of over 200 PEs started in 1995. However, after an initial phase of success in mid 1990's, the sale of enterprises practically stopped in 2003.[7] Forty one PEs are reported to have been tendered but not sold. During 2001-2003 only seven PEs were sold for just over Birr 20 million. As of today, the total PE sector comprises 157 enterprises, excluding utilities, of which 138 have been slated for privatization. The majority of the PEs (62 percent) are in the industrial sector (the largest being construction and textiles), accounting for nearly 70 percent of the sector, followed by the services and agriculture sectors (24 percent and 14 percent respectively).

The Government is committed to accelerating the privatization program of commercial PEs (excluding utilities) and has identified a number of issues to be addressed that contributed to the slow-down of the privatization process. These relate to the duplication of functions in institutions dealing with PE reforms; the cumbersome procedures governing the process; and the inclusion of labor and land issues as part of the privatization transaction (Annex 4). The Government recognizes that these bottlenecks need to be removed for the privatization program to accelerate and is committed to put measures in place to achieve this objective. As a first step to resolve the situation, the Government has merged the two institutions thus far responsible for the privatization program into the Privatization and Public Enterprise Supervisory Authority (PPESA), which will coordinate the implementation of the privatization program with the activities associated with supervising public enterprises. Further, the Government has prepared a Privatization Action Plan, geared towards accelerating the privatization program and addressing the issues of labor redundancy.

[6] Calculations based on data from the 2003 CSA survey of the large and medium scale manufacturing industries including 143 PEs out of a sample of 909 firms.

[7] At the time of commencement of the reforms, the PE sector consisted of 212 enterprises (at holding/parent level before unbundling), which contributed approximately 20 percent of GDP. As of the end of 2003, 214 PEs were sold (of which 152 were unbundled from six enterprises) and the total sales proceeds amounted to Birr 3.2 billion, 70 percent of which was accounted for by 8 transactions.

Weak competition and lack of level playing field

In addition to privatization, another way of increasing private sector participation in the economy is through facilitating the entrance of new firms, domestic and foreign. A number of factors are important before an investor can make a long-term financial commitment in a country, of which the most important one is an effective system of laws, regulations and institutions ensuring fair competition and a level playing field. Unfortunately, Ethiopia has particularly weak domestic competition and market contestability in many sectors (CEM, UNCTAD). As described above, Ethiopia maintains a highly monopolistic structure of the economy with state-run or controlled enterprises in many sectors. Results of ICA (2002) and its update (2004) as well as UNCTAD Investment Guide to Ethiopia (2004) indicate the private sector's perception of an uneven playing field and preferential treatment of the public sector firms in areas such as access to physical infrastructure and administrative and financial services. Further, UNCTAD report indicated that there was some concern arising from the widespread operations of the enterprises associated with the political parties within the current ruling coalition, so called, "foundation" companies. [8] The Government has recognized these issues and has already commenced implementing measures to address them, such as the privatization program and competition policy framework, as discussed further below and in Annex 1.

Once the privatization program picks up momentum, it is likely that main changes in overall industrial structure and market dominance will occur in the short- to medium-term. Consequently, in parallel with the actions related to the privatization program, it will be necessary to undertake competition policy related activities to ensure that the privatization program is designed and implemented in a manner that facilitates entry of new players in the market and limits the dominance of incumbent enterprises in markets and sectors (irrespective of whether entrants are foreign or domestic, public or private, or for profit or not).

The Government has started reforms aimed at increasing domestic competition. A Trade Practices Proclamation came into force in 2003 and established rules on anti-competitive practices such as price collusion, abuse of market dominance, anti-dumping and consumer protection. The Government has indicated its intention to proceed with the implementation of the Proclamation. A Competition Investigation Commission and a Secretariat have been established within Ministry of Trade and Industry (MOTI) and the members for the former body have been appointed, including representatives of the public and the private sectors. The Ministry plans to use the Domestic Trade Department as the secretariat for the Competition Commission.

Weak integration of Ethiopian economy into the regional and international economy

Ethiopia is poorly integrated into the regional and international economy and it has not been able to reap the benefits of the rapid expansion of international trade over the last decade, particularly in sectors where it has potential, such as non-traditional agricultural products (horticulture and food processing), labor-intensive manufacturing activities (garments, leather products), and tourism. FDI penetration and entries of new firms in domestic markets remain limited – foreign direct investment (FDI) increased only slightly from US$105 million in 2001/2002 to US$189 million in 2002/2003. Comparing FDI inflows as a share of GDP, Ethiopia still lags behind the Sub-Saharan average by almost ten percentage points. Export earnings are equal to only 16 percent of GDP, and the country continues to be heavily dependent on coffee, which accounts for some 40 percent of merchandise exports. Ethiopia's manufactured exports

[8] These companies, established as foundations at the end of the civil war, are well-capitalized private businesses understood to be under the effective control of coalition parties, either through shareholdings held by party-controlled foundations, or by individual shareholdings held by high-ranking party members. They are active in most major sectors, including fertilizer, cement, transport, insurance and microfinance/MFIs.

account for only 10 percent of its already small export total while exporting Ethiopian firms account for less than 8 percent of the population of firms.

The Government expressed its commitment to increase the integration of the Ethiopian economy into the regional and international economy by implementing policies and measures facilitating trade and investment, as recommended during the Diagnostic Trade Integration Study (DTIS) consultations.[9] As a first step, the Government has already relaxed some restrictions on foreign ownership and become more open to private sector activity in energy production (although urban power distribution remains a state monopoly). The next step would be to gradually remove constraints in key sectors, such as the financial sector, telecommunications, infrastructure, and domestic wholesale and retail activities. The process of acceding to the World Trade Organization (WTO) can facilitate this opening up, while also sending a clear signal to foreign and domestic investors that the GOE is committed to these reforms and that there will be no slippage. Consequently, WTO accession emerged as a top priority during the DTIS consultations.

Ethiopia is currently holding observer status in WTO and its request for accession to the WTO was accepted in 2003. The Memorandum on the Foreign Trade Regime has been finalized and submitted to the Council of Ministers for approval. After this, MOTI will formally submit the Memorandum to the WTO, which will launch the accession process. Further, recognizing the challenge ahead, the GOE has decided to create a well-staffed department devoted to this task within MOTI. Internal capacity-building is underway and will be assisted by the public sector reform program as well as an European Union (EU) grant.

Weak Enterprise Skills and Institutional Support to PSD

The results of the ICA clearly show that productivity and competitiveness of SMEs in Ethiopia are among the key constraints to their growth and development. While the reasons for the labor productivity shortfall are manifold, it seems that the single largest contributor is the low level of skills. Indeed, according to the Ethiopian Development and Research Institute (EDRI) survey of micro and small enterprises (2004), nearly 90 percent of workers did not receive any pre or post vocational or technical training. In addition, business development services (BDS) market is probably one of the least developed in the world. As a result, a high 70 percent of non-exporting firms noted the inability to produce to clients' standards and specifications, and the high cost of meeting the clients' technical requirements among the primary reasons for not engaging in export/import activities (ICA). Another 20 percent reported the high costs of establishing foreign distribution networks as among the main constraints to exporting. Clearly, lack of BDS services, facilitating knowledge and technology transfer, severely limit the potential of firms to enter and compete in the international and regional markets.

Further, as in many African countries, the Ethiopian private sector also faces a significant credit constraint. According to ICA, about 28 percent of private firms ranked lack of credit as one of their three biggest problems.[10] It also appears that obtaining credit is a greater challenge for SMEs than for large enterprises.

Institutional support to PSD is also weak. Public and private sector institutions, such as sectoral and professional associations, chambers of commerce, investment, export promotion, quality and standards agencies, etc., have limited capacity to effectively play their supportive role. Most of the industry-specific

[9] See Annex 4 for more details.

[10] Inadequate access to credit, high collateral requirements (an average of 136 percent of loan value), and high interest and transaction costs of obtaining loans from banks are cited as the chief causes of constraints. A majority of private businesses do not have a long business relationship with their primary bank.

and professional associations are relatively new and unclear about their role; have low membership and few services of benefit to members, thus insufficient fee income. Sectoral associations have not yet established good links with international networks, so as to learn from experiences elsewhere on how to develop creative new income-generating services, and how to increase membership penetration. A very similar pattern exists in professional institutes and associations.

Clearly, capacity building (CB) of firms and PSD-supporting institutions; strengthening of BDS market so that Ethiopian firms can acquire necessary skills and technology to improve their labor productivity, structure and organization of their business is of critical importance for Ethiopia to meet its growth and poverty reduction objectives. Also, broadening access to financial services, strengthening entrepreneur capacity to borrow from banks, and promoting entrepreneurship and business innovation would be key to improving efficiency and productivity in the Ethiopian private sector.

2. Rationale for Bank involvement

The Bank's Country Assistance Strategy (CAS), presented to the Board in March 2003, was based on Ethiopia's SDPRP and focused on three inter-related themes: (i) enhancing pro-poor growth, (ii) enhancing human development outcomes by improving governance, and (iii) reducing vulnerability.[11] All three themes were to support the achievement of the overarching goal, as stated in the Government's SDPRP, of reducing poverty and achieving the Millennium Development Goals (MDGs) in a sustainable way. The PSD CB project, as indicated in the CAS, is consistent with the overall GOE strategy and its efforts to remove the key obstacles to PSD and support a faster private sector-led economic growth.

The thrust of the Bank's program under the current CAS for FY 2003 to 2005 supports the goals set forth in the SDPRP through a mixture of lending and analytical instruments, which were developed to support the evolving institutional structures of Ethiopia. In this context, a series of annual budget support operations, Poverty Reduction Support Credits (PRSCs), were developed to support policy reforms measured by tangible Government actions specified under this framework. The second of the series, PRSC-II, discussed by the Board on November 30, 2004, has a substantial PSD policy content in the areas of privatization, competition policy and WTO accession. There is a clear synergy and complementarity between the PRSC and the PSD CB project. While the PRSC is a vehicle for policy dialogue and facilitates addressing policy and regulatory issues, the PSD CB project provides financial support and technical assistance necessary to enable the Government to implement key PSD policy reforms agreed under the framework of PRSC. Thus, the project will serve as a catalyst for reforms. As mentioned above, due to the programmatic nature of the PRSC and long-term nature of the PSD agenda, the PSD CB project should be seen as the first in the series of operations supporting the Government in achieving its objective in improving the climate for investment and operations of the private sector. If the activities supported under the project proceed rapidly, the Bank may consider providing supplemental financing to the project.

The PSD CB project is complementary to ongoing efforts led by the Bank and other donors (see Annex 2) and will focus on addressing the remaining constraints to PSD. Other donors, particularly European Union (EU), African Development Bank (ADB), UK Department for International Development (DFID), U.S. Agency for International Development (USAID) and United Nations Development Program (UNDP), have actively supported PSD, in some cases through an integrated program with similar pillars of assistance (business services, trade facilitation and capacity building, business environment). During the project preparation, the Bank team consulted and coordinated with the donors bilaterally as well as with two donor groups established for the DTIS follow-up (PSD Working Group) and for the PRSC-II preparation (PSD Technical Team).

[11] CAS Progress Report was completed in August 2004.

As a result, the PSD CB project has been designed so that it complements activities funded by other donors. In the area of capacity building, the PSD CB project complements the EU-funded Micro and Small Enterprise Development Program (MSEDP due to close in 2005) focused on building capacity of the micro firms and micro-finance institutions (MFIs). In the area of WTO accession, the PSD CB project supplements the support offered by the EU which will focus on Ethiopia's negotiations with the EU through an Economic Partnership Agreement (EPA) and implementation of the Common Market for Eastern and Southern Africa (COMESA) regional integration agenda. The project will also complement the USAID proposed support which focuses on the legal and administrative dimensions of WTO accession. In the area of privatization, Bank support complements programs of ADB and DFID. The donors welcomed the World Bank's involvement and assistance in addressing important gaps.

3. Higher level objectives to which the project contributes

The ultimate objective is to facilitate increased growth and competitiveness of the Ethiopian private sector. This objective is aligned with the Bank's CAS and with the Government's commitment to stimulate PSD to attain high and sustainable level of growth needed to reduce poverty and realize the MDGs.

B. PROJECT DESCRIPTION

1. Lending instrument

The project will be supported by a specific investment loan (SIL) in the amount of US$24 million equivalent, of which US$5 million equivalent is a grant. This instrument is the most appropriate as it will provide direct financing for activities, which will increase competencies of the Ethiopian stakeholders and thus facilitate the implementation of the reform program. The activities have been identified through the policy dialogue with the Government under the framework of PRSC as well as through consultations with a wide range of stakeholders (including the private sector, civil society and donors) to achieve higher levels of competitiveness and growth. The project will be implemented over five years.

2. Project development objective and key indicators

The key objective of the project is to facilitate increased participation of the private sector in the economy by creating conditions for improving its productivity and competitiveness. This goal will be achieved by helping accelerate the process of divestiture of public enterprises and facilitating increased private participation; improving the business environment and increasing competition and the contestability of markets; strengthening the linkages and integration of the Ethiopian economy into the global markets; strengthening support for technical and business management skills and thus improving the productivity at the firm level. The project integrates complementary and mutually reinforcing activities to support enterprise needs, including a matching grant fund, tools for business schools to better train managers, and a business plan competition to catalyze innovation, and entrepreneurship. The project, particularly components relating to privatization, competition and WTO, support implementation of policy measures agreed in the framework of the PRSC, and thus the poverty reduction strategy of the Government.

3. Project components

To support the implementation of agreed policy measures under PRSC-II, as well as to build the capacity of the private sector, the PSD CB Project consists of three components (see Annex 4 for a detailed description).

(i) Component One - Accelerating the Implementation of Privatization Program;
(ii) Component Two - Improving the Business Environment through Implementation of Competition Policy and Accession to the WTO
(iii) Component Three - Strengthening the International Competitiveness of the Private Sector and the Capacities of its Representative Organizations.

Component One - Accelerating the Implementation of Privatization Program (IDA US$9.87 million)

This component will assist the Government in accelerating the implementation of its Privatization Program of commercial public enterprises. The Government has recognized that its early approach to privatization needed to be revised substantially, and outlined the key principles and approach to the privatization process in a Privatization Action Plan, which the PSD CB project will help implement over the next five years. The Plan is geared towards accelerating the privatization program. To achieve this objective, the Government intends to make use of a range of divestiture modalities including asset sale, concessions, leasing, joint ventures, management contracts, etc. The Government will adopt process-driven procedures in transactions using a market-oriented, open, transparent and competitive bidding process. Further, in order to address concerns of potential investors related to labor issues, the divestiture process will allow the successful bidder flexibility to restructure the labor force of the enterprise. To mitigate the social impact of possible redundancies that may result, the Government will develop and introduce a retrenchment program. The details of the program (i.e., the options offered to redundant workers, that may include voluntary redundancy, retraining, counseling, early retirement, etc.), a defined formula in accordance with existing legislation, institutional arrangements, as well as a mechanism that ensures that staff benefiting from the program will not be rehired by Government, will be designed prior to the implementation of the retrenchment program.

This component will provide financial and technical assistance in the following areas:[12]

(i) *Institutional capacity building of the Privatization and Public Enterprise Supervisory Authority (PPESA)* – This activity will cover training of the PPESA staff and board members on specific topics such as negotiating skills and contract management. An enhanced information system, building on the systems that were in use in PESA and EPA, will also be designed and implemented.

(ii) *Transaction advisory services to the divestiture process* – This activity will support transaction advisors to assist PPESA at various stages in transactions, from preparation through to closing for selected larger and more complex transactions.

(iii) *Environmental Audits* – This activity will fund full and partial environmental impact assessments, identified as required during the environmental pre-audit.[13]

(iv) *Retrenchment program* – This activity will assist in dealing with excess labor in public enterprises slated for privatization.[14] The program will be co-funded by Government and investors and will

[12] This component has been designed taking into consideration the support ADB has been providing to the EPA and plans to continue providing to PPESA. In selecting activities for IDA support, account has been taken of the activities that the ADB has earmarked for funding. Continued coordination with the ADB is intended throughout the life of the project.
[13] If required, the project will fund capacity building of the Federal Environmental Protection Authority (FEPA).
[14] The US$7 million of IDA funding earmarked for this activity is likely to be adequate only for the initial phase of the program. Should the program prove to be successful, additional funding will need to be sought.

provide a package of benefits, which will be determined by a short term consultancy funded by the project to assist in the design of the program.[15]

(v) *Studies* - A short term consultancy will be funded to help design and implement a system to monitor compliance by investors with contract covenants.

Component Two - Improving the Business Environment through Implementation of Competition Policy and Accession to the WTO (IDA US$1.1 million)

This component aims at assisting the Government in the effective implementation of its competition policy, preparation for WTO accession negotiations, and long-term capacity building for the formulation and implementation of trade and competition policy. The ultimate objectives are to maintain and encourage competition, strengthen integration in the world economy, increase economic efficiency and competitiveness, and promote consumer welfare. Technical assistance and training will be provided under the two sub-components covering competition policy and WTO accession.

Subcomponent A – Implementation of Competition Policy (IDA US$450,000)

This sub-component will assist in the implementation of the Trade Practices Proclamation in order to ensure a level playing field, fair business practices, and greater accountability and transparency in government-business relations for all economic agents. It will consist of the following elements:

(i) *Preparation of implementation guidelines, regulations, procedures and methods* relating to various provisions of the Proclamation. In addition, assistance is included for the review, evaluation, and changes to improve the Proclamation.

(ii) *Staff Capacity and Institution Building* through the provision of short term visiting international experts/advisers to provide advice and materials on case specific matters, investigative techniques, evaluating evidence, and conduct staff training workshops and public information dissemination programs. Also included is support for staff participation in short-medium term educational programs-courses, workshops, etc.

(iii) *Materials*. A limited amount of supplies will be provided to ensure that staff in the Competition Commission, the Secretariat and in MOTI have the material support necessary to do their jobs.

Subcomponent B – Support to WTO Accession (IDA US$650,000)

The project will help the Government prepare for negotiations on WTO accession by supplementing other bilateral assistance and coordinating closely with other donors and international agencies involved in the process. It will consist of the following elements:

(i) *Analytical studies* of the different policy options open to the Government as it considers the degree and pace of liberalization that it is prepared to offer in various sectors. These studies will assess the likely economic impact of reform drawing on international experience but based on the specificities of the Ethiopian economy. The studies will include detailed treatment of the appropriate regulatory framework required for successful liberalization and assess the current state of play in Ethiopia.

[15] The redundancy package could include measures such as voluntary redundancy, early retirement, counseling, retraining and out placement, for redundant workers.

(ii) *Short-term advisors* to help in the preparation of responses to questions from WTO members, the elaboration of negotiating positions, and the delivery of workshops.

(iii) *Training.* In addition to dissemination workshops for all studies, various seminars will be conducted for the private sector, civil society and parliament, in Addis and the provincial capitals, in order to improve public awareness of the objectives, issues and challenges involved in WTO accession.

(iv) *Materials and workshops.* A limited amount of materials and documentation will be provided to ensure that staff in MOTI and one or two other key Government ministries have the material support necessary to do their jobs.

Component Three - Strengthening the International Competitiveness of the Private Sector and the Capacities of its Representative Organizations (IDA US$8.0 million)

This component will help strengthen human and institutional capacity of the private sector. It includes three complementary and mutually reinforcing sub-components for which the PSD CB project will provide financial and technical assistance:

(i) *BIZCAP* – aimed at building international competitiveness within private firms, and at building the capacity of private business and professional associations and of chambers to better serve their members.
(ii) *BIZPLAN* – Business Plan Competition aimed to support and grow private small and medium enterprises (SMEs) in Ethiopia.
(iii) *SCHOOLCAP* – Global Business School Network aimed to strengthen the institutional capacity of the Faculty of Business and Economics at the Addis Ababa University.

Subcomponent A – BIZCAP (IDA US$5.75 million)

This sub-component consists of two "windows." The first, FIRMCAP (IDA US$5 million), focuses on building the international competitiveness of Ethiopian private firms, so that they can compete in both domestic and international markets. The proposed basic delivery mechanism is a Matching Grant Scheme (MGS) where an individual firm will finance an agreed proportion of the costs of training and/or technical assistance it desires. FIRMCAP will build on long World Bank experience of operating similar MGS schemes in many developing countries. Three types of activities will be carried out within FIRMCAP: (i) pro-active promotion to firms of the benefits of using business development services, in order to build competitiveness; (ii) free, on-going hand-holding and advice in preparing their requests for grant funding; and finally (iii) the grants themselves including approving requests on the basis of compliance with clear eligibility criteria, and monitoring implementation of supported activities.

The MGS concept is different from most traditional approaches as the scheme is deliberately temporary. The main "institution-building" achieved will be within each individual firm. The grants will decline over time, so as to reduce the risk of a "grant culture" being developed. The help given is deliberately partial and the firm must make a meaningful contribution to costs. Experience shows that this is essential to ensure real commitment and ownership. In return, however, it is the firm and not the scheme that decides on activities to be supported and that selects the service provider. The firms self-select, and are supported on first-come, first-serve basis. Also, the firm will reveal to the responsible MGS management unit its detailed and confidential competitiveness-building plans. To assure this, management arrangements are designed to ensure, so far as possible, that firms will have full confidence that commercial confidentiality will be maintained.

The second window, ASCAP (IDA US$750,000), will provide support to private sector entities such as business and professional associations and chambers of commerce, so as to improve their advocacy capabilities, expand membership, and where appropriate, regulate professional codes of practice. It operates under most of the same principles as apply to FIRMCAP.[16] It aims at encouraging the use of outside expertise to build capacity within associations and chambers.

Subcomponent B – SCHOOLCAP (IDA US$1.6 million)

This sub-component will build on the IFC initiative called the Global Business School Network (GBSN) started in 2002 to strengthen the institutional capacity of Business Schools in developing countries. SCHOOLCAP will improve the capacity of the Faculty of Business and Economics at the Addis Ababa University, which is the only institution in Ethiopia that awards graduate degrees in management and finance. Taking into account the composition of students obtaining their degrees at the Faculty of Business and Economics (FBE) at the Addis Ababa University,[17] building their capacity will impact the private sector throughout Ethiopia.

Through its activities, SCHOOLCAP will contribute to the development of a cadre of the middle managers, that will be needed by an expanding private sector. It will also help strengthen the entrepreneurial spirit and innovativeness in the Ethiopian economy. Finally, it will also strengthen the capacity of the public service to better understand and respond to the needs of the private sector.

SCHOOLCAP will upgrade the program curriculum and support the implementation of the revisions. In addition to other courses designed for the new curriculum, courses will be designed in the areas of competition policy and WTO accession. This sub-component will also include an annual training to transfer skills to the other business schools as well as a regular publication both to communicate new knowledge and record the development of business education in Ethiopia.

Subcomponent C – BIZPLAN (IDA US$650,000)

BIZPLAN, or Business Plan Competition, will assist GOE's efforts to support and grow private SMEs in Ethiopia. BIZPLAN Competitions have proved to be an excellent vehicle to identify and support promising small-scale projects in other countries.[18] The Ethiopian BIZPLAN aims to provide technical and financial assistance to Ethiopian SMEs thus enabling these entrepreneurs to strengthen their skills and increase the availability and quality of services, both financial and technical assistance, to them. By engaging the private banks, BIZPLAN will also strengthen and develop their institutional capacity to provide better services, financial and non-financial, to the private sector.

The Ethiopian BIZPLAN will promote competition among entrepreneurs for new and pioneering ideas aimed at increasing efficiency and productivity, and demonstrate to Ethiopian banks that lending to SMEs is an attractive and viable business line. Finalists of the BIZPLAN will receive technical assistance (TA) from the competition organizer and winners of the BIZPLAN will receive a financial award that would be

[16] Specifically: (i) it is temporary; (ii) it is partial, although grants are more generous, given a lower ability to pay; (iii) it is first-come, first-serve, with the same emphasis on allowing recipient organizations to decide on activities, and to select their own service suppliers.
[17] Approximately 75 percent of the students at FBE are teachers or civil servants, while the remaining 25 percent come from the private sector.
[18] The BIZPLAN methodology will be based on best practice and the cumulative experience of the World Bank's Development Marketplace (DM) Competitions. Since 1998, the DM team has supported over 20 country-level competitions and 3 Global Competitions worldwide. Another 10 are planned for 2004-05. In 2003, a DM targeting NGOs and Civil Society Organizations was held in Ethiopia.

placed as collateral in the private banks participating in the scheme, against which the bank(s) would provide leveraged lending. The TA and finance combination is designed to address the two main constraints to entrepreneurship growth.[19] The process of identifying the winners is open, transparent, and highly visible, making it attractive for the participants to put their best ideas forward and for the organizers/sponsors to highlight key issues and priorities.

4. Lessons learned and reflected in the project design

The project has been designed drawing on the World Bank's experience in Sub-Saharan Africa and other regions, and has benefited from inputs of various World Bank Group networks and global products groups, including Finance, Private and Infrastructure (FPSI) network, IFC Global Business School Network, Corporate Strategy Group, World Bank Institute (WBI) and Investment Climate Unit. The project also benefited from inputs from the private sector, civil society and academia, which contributed during the workshops organized as part of project preparation.[20] Finally, the project was prepared in consultation and with contributions from the PSD Donor Technical Team.

In addition, several analytical studies provided important inputs into the design of the project, including several Government studies funded under the PHRD grant (i.e., Developing a Design for a Matching Grant Scheme for Private Sector in Ethiopia, Development of a Capacity Building Program for Sectoral and Professional Associations, WTO Road Map, Categorization of Public Enterprises by Modes of Divestiture); and the World Bank Studies (Investment Climate Assessment and its update, Country Economic Memorandum with its several background studies, Principles and Approaches to Privatization in Ethiopia); as well as other donor-funded studies and evaluation reports (EU, GTZ, ADB).

Based on the above, the project design reflects the following key lessons learned:

(i) *Integrated approach focused on nurturing the private sector.* A principal objective of the project is to increase private sector participation in the economy, which called for an integrated package of interventions aiming to address the interrelated constraints and create an environment for a sustainable PSD.

(ii) *Close collaboration with key stakeholders.* To ensure that there is ownership and a buy-in of the project and its measures by the Government and the private sector, the project team has carried out extensive consultations during project preparation, including workshops and seminars on WTO accession, Capacity Building and Competition Policy. In addition, the team coordinated with the donor community during project preparation to minimize overlapping and duplication, and to benefit from synergies where possible. The team will continue these close relationships during the project implementation.

(iii) *Privatization.* Three lessons of experience have been taken into account. First, it is important that a well-designed communications program be implemented to build understanding within the executive, congress, the judiciary, trade unions, the PEs themselves and the general public on the need to improve key areas of the economy and increase investment for growth.[21] Secondly, it is

[19] Participation and involvement of private banks throughout the BPC process is a pre-requisite for BIZPLAN to be operationalized, as they will ultimately provide loans to the winners. Agreement with one private bank has been finalized during the appraisal mission and other private banks are considering signing similar agreements.
[20] Using PHRD funding, three workshops were organized on WTO accession, Matching Grant Scheme and Competition Policy.
[21] Communication campaign for privatization will be funded by ADB. Communication aspect is also taken into account in the area of competition policy, as this is an unknown area for Ethiopia, and will be funded by the project.

important for the Government to address the issues of redundancy up-front and as part of the privatization process. Third, while it is important to address the issue of competitive markets before and during the privatization process through the framework of the Competition Law (rather than dealing with unintended consequences after the fact), it is critical that privatization of major firms happens in an environment that maximizes the potential for entry and competition using open, transparent and competitive mechanism.

(iv) *Importance of competition policy – framework and implementation.* While it is important to have a good competition policy framework, it is more important to have proper implementation, and a monitoring and evaluation mechanism in place. The Ethiopian economy continues to be dominated by state owned and 'party affiliated' enterprises and an effective competition policy can be instrumental in not only preventing monopolization of markets, but fostering greater accountability and transparency in government-business relations. It will also broaden opportunities for participation in the economy by lowering public policy-based and private barriers to entry, and bolster investor confidence by ensuring a level playing field between different types of enterprises.

(v) *WTO accession contributes to reforms.* The terms of accession generally lead to greater openness, which promotes foreign investment and improves the enabling environment for domestic private enterprise. Experience from other countries indicates that a well-designed package of support, including proper analytical work can expedite the process while ensuring that national developmental objectives are given priority.

(vi) *Cost sharing/matching grant.* Based on lessons of experience, the basic principles are as follows: demand driven, with cost sharing to ensure adequate willingness to pay and ownership; based on a realistic business development plan; reimbursement basis; gradually declining subsidy element; no productive activity is excluded; first-come, first-serve. Grants will be provided in tandem with pro-active promotion, and with free hand-holding "technical assistance" to firms. It is important to note that while these matching grants will go to private firms, the products developed and the demonstration effects of success will represent private goods that are expected to facilitate sustainability (i.e., private firms willing to fully pay for BDS services).

(vii) *Management of matching grant schemes.* Experience indicates that what works best is a combination of local professionals together with international MGS specialists. The local professionals bring to the task knowledge and appreciation of local culture, market realities, and business practices. The international MGS specialist(s) bring to the task international best practice in operating MGS schemes, plus appreciation of the market realities facing exporters when selling to distant industrialized countries.

(viii) *Development of bank-firm relationship.* The participation of the private banks in the BIZPLAN scheme is essential, as the sustainability of the results depends on the bank-firm relationship that will be developed and strengthened through this component.

5. Alternatives considered and reasons for rejection

Several alternatives were considered during project design. First, consideration was given to financing the technical support required through the PRSC. This approach was rejected because of the critical importance of the technical assistance in ensuring the success of the PRSP and the highly specialized nature of the assistance required. Second, the use of an Adaptable Program Credit (APL) approach was considered as technical support for the PSD agenda is expected to be over a long period and involve several operations. However, the program is expected to evolve over time and it is difficult to predict ex-ante the requirements. This made the program less suitable for an APL. In addition, it was concluded that it is important to maintain flexibility in the use of instruments; for instance, some incremental support might be able to be efficiently provided through supplemental credits, as opposed to a second phase of an APL. Another alternative explored in project design was to include a large component for staff retrenchment, which has proved an effective mechanism for accelerating the divestiture process in other countries (e.g., Uganda and Cape Verde). This alternative was rejected in order to test the proposed retrenchment arrangements. If successful, retrenchment funds could be included in a supplemental credit to this operation.

C. IMPLEMENTATION

1. Partnership arrangements

The PSD CB project was designed and will be carried out in close collaboration with other donors, as described in Section 2. Close collaboration is expected to continue with the following donors: (i) the EU, especially on matters relating to Micro and Small Enterprise Development Program (MSEDP) and the trade facilitation program which will assist with Ethiopia's accession to the WTO; (ii) USAID which is providing assistance in the legal and administrative dimensions of WTO accession; and finally (iii) in the area of privatization, the Bank work complements support of ADB and DFID.

2. Institutional and implementation arrangements

The overriding principle guiding the institutional and implementation arrangements of the project is mainstreaming the operational responsibility to the institutions/agencies that are already in charge of implementing the policy agenda in the areas of privatization, trade policy, including WTO, and Competition Policy. The management of BIZCAP and BIZPLAN will be delegated to Enterprise Ethiopia (EE), a project office under MOTI that is dedicated to upgrading business skills within the country, through the BIZCAP Management Unit (BMU). The Faculty of Business and Economics (FBE), University of Addis Ababa will be responsible for the implementation of SCHOOLCAP.

The oversight of the project will be formally delegated by the Minister of Trade and Industry to a Public-Private Steering Committee (PPSC) chaired by the Minister of Trade and Industry. The PPSC will consist of nine members with membership from the public and the private sectors. The Steering Committee will be assisted by a small Project Coordination Unit (PCU), funded jointly by the project the Government, and located within MOTI. The Government will fund the procurement and financial management (FMS) specialists, and office costs (including office space, communications and equipment), while the PSD CB project will fund the Project Coordinator and necessary training, establishment and operation of an M&E system, and semi-annual audit costs of accounts. For the purpose of effective implementation and speedy disbursement, the PCU will be dedicated exclusively to the management of the PSD CB Project. Based on the recommendations of the procurement and FMS capacity assessment of MOTI conducted during the appraisal mission it has been agreed that the PCU will be staffed with dedicated full-time personnel, assigned or employed for the period of the project. The PCU will comprise of a minimum of three staff - a

Project Coordinator (funded by the project), a procurement specialist and a financial management systems specialist (funded by the Government). The PCU would be responsible for handling procurement and FMS functions for the project. A tendering committee composed of some members of the MOTI tendering committee and the PCU procurement and FMS specialists would be responsible for evaluation of bids, both for selection of consultants and goods procurement. End users of the procured services or goods would participate as members of the tendering committee as required to ensure that the procurement is done according to their needs. Final decisions on procurement will be made by the respective heads of the various components. The detailed procedures to be followed are outlined in the Project Operational Manual (POM).

Project management and implementation for all components will be mainstreamed/delegated to the following agencies: (i) PPESA for Component One, (ii) Competition Secretariat for Subcomponent A, and the WTO Department in MOTI for Subcomponent B under Component Two; (iii) Enterprise Ethiopia for BIZCAP and BIZPLAN, [22] through the BMU staffed with a competitively selected matching grant manager charged with running the BIZCAP scheme,[23] and a BIZPLAN officer charged with running the BIZPLAN. The MGS manager will be assisted by a Matching Grant international expert advisor; and (iv) Faculty of Business and Economics, AAU for SCHOOLCAP. Further, for Component Four, a dedicated sub-committee will be established (Capacity Building Sub-Committee) under the PPSC, with the membership from public and private sectors, which will be responsible for the oversight of all three sub-components of Component Three. Detailed project implementation arrangements are presented in Annex 6.

A Project Operational Manual including the Project Implementation Plan, Financial Management Plan and procurement Plan will be finalized by project effectiveness. The POM will include all periodic reporting, monitoring and evaluation arrangements throughout the life of the project and will include independent operational audits annually, which will provide impact assessment of the various project components. A mid-term review date in mid-2007 will be agreed during appraisal with the objective of assessing progress to date and if necessary to re-direct the project by integrating additional lessons learned and realities on the ground.

3. Monitoring and evaluation of outcomes/results

An overall monitoring and evaluation (M&E) system has been prepared and is incorporated into the PIP. The M&E system is based on the agreed Result Framework presented in Annex 3. The PCU will be responsible for conducting M&E activities. Baseline data collection for all the agreed indicators will be initiated by the PCU during the start up phase. An outcome-oriented approach has been developed that would allow corrections during implementation to achieve the objectives and incorporation of lessons learned.

Project impact data collection will be manly the responsibility of the PCU and Statistic Department which will collect impact data on private investment contribution to GDP (including privatized firms); and the number of new jobs created in the private sector. The PCU and BIZCAP Implementing agency will be responsible of data collection on the value added per worker in participating firms. Data collection and management of outcome indicators will be the responsibility of the PCU and the implementing agencies for each component.

The PCU will be responsible for preparing all periodic fiduciary reporting requirement including impact and output indicators to IDA as well as the annual project audit. A mid-term review will be conducted

[22] EE will operate in accordance with the operational guidelines set out in POM.
[23] The matching grant manager will be head the BMU Unit (BMU Manager).

with the objective of assessing progress to date and if necessary to re-direct the project by integrating additional lessons learned and realities on the ground.

4. Sustainability

The project supports the Government's SDPRP and its policy commitments in the areas of restarting the privatization process, putting the Competition Law into practice and helping Ethiopia in the WTO accession process, reached through the policy dialogue conducted as part of the PRSC. Thus, a high degree of commitment is expected in the implementation of project activities. The PSDCB project will also address the constraints stemming from low capacity at the firm level by developing a matching grant scheme available to local firms to build their skills and improve their competitiveness. This area is particularly important if Ethiopia is to achieve higher growth. The importance of the project has been recognized by the Government and the proposed technical and financial assistance is perceived by the private sector as "long overdue". Nonetheless, to ensure the sustainability of the project results, a participatory process with strong private sector involvement will be established to ensure the pressure from the private sector on Government authorities to implement and maintain the expected reforms.

5. Critical risks and possible controversial aspects

The major risks facing the successful implementation of the project are:

Risk	Risk Rating	Risk Mitigation Measure
From Outputs to Objective		
Government commitment and timely implementation of the PSD policy agenda under the PRSC and of the public sector reform program supported by PSCAP	M	This aspect is especially important in the areas of privatization, competition policy and opening the economy as a result of WTO accession process, but also includes trade policy, infrastructure support, financial sector reform and reform of the tax regime. To mitigate this risk, continued dialog with the Government under the framework of the PRSC budget support operations is critical. Further, strengthening and supporting the private sector by building its capacity to engage in a meaningful dialog with the Government could serve as a good mechanism for effective and timely implementation of reforms.
Weak supply response from the private sector.	S	This risk concerns mostly Component Four, which is designed based on a demand-driven principle. While this may not pose a problem in Addis Ababa, as the nation's capital is also a business capital of Ethiopia, it may be a constraint in the smaller towns and rural areas. Lack of sufficient supply response may also negatively affect the intended outcomes of the project such as increased growth and investment of the private sector. Active promotion of the project in the regions is expected to encourage a positive response from the private sector.
From Components to Outputs		
Government continued commitment to the implementation of the Privatization Program.	S	Implementation of the Privatization Program requires Government commitment to a number of politically sensitive policies, most especially making workers in PEs redundant and guaranteeing flexibility to new owners to determine the structure of their work forces post privatization. Good design and implementation of the retrenchment program and effective dialog with labor unions as part of the communications program should help mitigate this risk. Further, it is important that the Government adhere to the market-based approach to privatization advocated in the Privatization Action Plan.

Risk	Risk Rating	Risk Mitigation Measure
Private-public partnerships.	M	The Government has indicated its intention to actively involve the private sector and its representative bodies (chambers and associations) in a policy dialogue, monitoring and evaluation of implementation. The implementation arrangements under the project support this objective, as the Steering Committee of the project will include representation from the public and private sectors .
Capacity of MOTI to implement the reform program and coordinate with other ministries.	S	Intra-ministerial cooperation and coordination will be critical for a successful implementation, as a number of sectors will be affected by implementation of the competition policy, privatization program and WTO accession. The project implementation arrangements provide for the establishment of a Steering Committee that would include members from the private sector and the relevant ministries, which will help ensure coordination. Further, the implementation capacity of MOTI may become an issue, at least in the short to medium term, as the Ministry is undergoing restructuring to ensure adequate human capacity to fulfill its mandate. To mitigate this risk, the technical responsibility for the implementation of the technical components has been designated to the institutions already responsible for the specific reforms and the project provides implementation support arrangements in terms of short-term consultancies and training
Overall Risk Rating	S	

Risk Rating – H (High Risk), S (Substantial Risk), M (Modest Risk), N (Negligible or Low Risk)

6. Loan/credit conditions and covenants

Effectiveness Conditions:

(i) The Borrower has adopted the Project Operational Manual, including a project implementation plan for the first year and a manual of administrative, financial and accounting procedures, satisfactory to IDA.

(ii) The Borrower has established a PCU with key qualified personnel, including a Project Coordinator, financial management and procurement specialists, all having experience and qualifications satisfactory to IDA.

(iii) The Borrower has opened a Project Account at the National Bank of Ethiopia and has made an initial deposit.

(iv) MOFED and MOTI have entered into a Letter of Undertaking for the purpose of project implementation, in form and substance satisfactory to the Association, and such Letter of Undertaking has become effective

Disbursement Conditions:

(i) Disbursement of funds for retrenchment financing is conditional on the Borrower's furnishing to IDA a retrenchment program design and disbursement mechanism, satisfactory in form and substance to the Association.

(ii) The Borrower has adopted the Operations Manual for the Matching Grant Scheme under BIZCAP and an international expert satisfactory to IDA has been selected prior to disbursement for BIZCAP.

Other Covenants:

(i) The Borrower has recruited an external auditor, as directed by the Federal Auditor General, in form and substance satisfactory to IDA, to conduct the audit of the project financial transactions, including audit of payments of retrenchment accounts.

(ii) The Borrower has established a Public-Private Steering Committee within six months of project effectiveness. The Borrower will maintain the PCU under the Steering Committee during the life of the project.

(iii) The Borrower to conduct, in collaboration with IDA, mid-term review by June 2007.

D. APPRAISAL SUMMARY

1. Economic and financial analyses

The cost-benefit analysis focuses on three main components: investment climate/integration into the global economy, divestiture/retrenchment program, and international competitiveness. For the purpose of the analysis, the "integration into the global economy" subcomponent is factored in the investment climate. The numeraires used are output and employment income, which are expected to grow mainly as the result of increased productive investments, productivity, and greater access to export markets.

After running the model based on conservative assumptions, the project generates a net present value estimated at about US$22.6 million corresponding to an internal economic rate of return of 27.7 percent. The project is expected to positively affect employment as a result of increased demand for labor in all the sectors supported. However, the relatively low capacity utilization rate of 68 percent would slow down the rate of job creation. That said, during the lifetime of the project a minimum of 4,500 jobs are expected to be created. This number does not take into account indirect job creation which is also expected.

The Government fiscal position is also positively affected. Indeed, for the 12-year forecast time frame, the project would generate US$5.9 million as the result of incremental personal income taxes, corporate income taxes. This amount does not take into account divestiture proceeds. The detailed results are presented in Annex 9.

2. Technical

The project draws heavily on the results of the ICA that demonstrated the need to integrate policy reforms initiatives and improve the business environment with technical and financial support to nurture the private sector and assist in its repositioning to a market-led economy. The project aims to improve business environment through increased competition and contestability of the markets and opening up the key sectors as a result of accessing WTO. The project aims to bring new technology and management know-how to private firms through the increased participation of foreign private sector in the divested PEs. The matching grant component is expected to provide an important impetus for skills and technological upgrading within private firms and private banks. BIZPLAN aims to instill the innovativeness and entrepreneurship into the young and inexperienced private sector. The approach is market-based and recognizes the importance of firm-level initiative to increase investment, productivity, quality and reliability of the product.

3. Fiduciary

The project will be implemented with a new PCU to be established before project effectiveness. As a result, the Government will ensure that the financial management system is carefully planned and developed as indicated in the action plan shown in Annex 7. Establishment of adequate financial management system, among other things, includes development of a financial management manual and appointment of key finance staff at the PCU. Before declaring the project effective, the required assessment on the establishment of adequate financial management system will be conducted by IDA.

The overall conclusion from the Ethiopia CFAA exercise is that considerable progress has been made in the rationalization and strengthening of the budgeting process at the Federal level. Various capacity building efforts are also being undertaken at the regional levels. Despite some progresses made in last three years, there are weaknesses in medium term planning, accounting, auditing and reporting.
The Federal Auditor General will assign external auditors, acceptable to IDA, to conduct the audit of the project financial transactions.

4. Social

It is expected that the privatization program may lead to retrenchment of excess labor. In order to mitigate the social impact of possible redundancies that may result, the Government will introduce a voluntary separation package within a pre-determined time (e.g., six months) from the initial sale. The exact package (i.e., a menu of options that may include retraining, counseling, early retirement, cash option related to seniority, etc.), a defined formula in accordance with existing legislation as well as a mechanism that ensures that staff benefiting from the program will not be rehired by Government, will be designed prior to the implementation of the redundancy program. The PSD CB Project will provide financial and technical assistance in dealing with excess labor in public enterprises slated for privatization. The program will cover payment of a severance package and additional funding for a safety net providing a basket of services, such as counseling, retraining and out placement, for redundant workers. A short term consultancy will be funded to assist in the design of the program.

5. Environment

Environmental Category: B (Partial Assessment)
Experience has shown that successful privatization of industrial enterprises is intertwined with qualitative and quantitative assessment of the post, current, and future environmental, health, and safety issues. Moving PEs from the public domain to the private sector is not neutral in environmental terms as it raises the issue of responsibility for environmental impacts from past and ongoing operations as well as the broader concerns of environmental management. Such evaluation is also important for a potential buyer for whom a major issue is the associated environmental liability that results from a PE's purchase. Increasingly, financial institutions, as part of loan transactions, are also requiring evaluation of potential environmental liabilities associated with purchase. Thus, evaluation of environmental issues related to PEs is crucial. If the environmental aspects are appropriately addressed, the reforms may produce positive environmental effects, such as, increased efficiency in the use of natural resources and more rapid adoption of cleaner technologies.

In Ethiopia, many of the 126 privatization candidates, particularly in certain industries, may leave behind significant environmental risks or have already caused serious impact from their production and waste handling practices. The project recognized these facts and during preparation an environmental pre-audit was undertaken that: (i) measured the environmental and social conditions, for both past and on-going activities, of the selected enterprises against the risk of being held responsible for damage; (ii) determined the need for remedial actions necessary to bring a given enterprise into compliance with national and Bank safeguard policies prior to privatization; and (iii) formulated recommendations for partial and full audits for each facility or site, as applicable, and suggested a framework for subsequent audits.

As a result of this study, 24 PEs will require full environmental audits (EAs) and remediation plans; 72 PEs will require partial audits; 44 will require no audits (see Annex 10). The approach adopted has been to agree with the Government on a specific set of guidelines for conducting EA but to defer conducting the EAs as part of the transaction process for these PEs and prior to their divestiture, with funding provided by the project. The list of privatization candidates for which environmental audits would be undertaken was agreed and is included in Annex 10. When such audits are undertaken as part of privatization transaction, they will be reviewed and cleared by IDA.

The Environmental Pre-audit has also assessed the institutional and legislative support for conducting environmental audits as well as for monitoring and enforcement of environmental management in Ethiopia. The Federal Environmental Protection Authority (FEPA) has the responsibility for overall management of Ethiopia's environment. The Authority has been continuously improving the environmental management initiatives since its inception in 1995.[24] However, extensive work is still required to develop and refine the specific EHS guidelines and regulations to accommodate the different sectors; methodologies for monitoring waste and toxic products in industrial effluents; standards for monitoring environmental parameters. The institutional set-up of the FEPA should also be strengthened to enable it to conduct high quality EAs and adequately monitor and enforce adherence to the national environmental standards and regulations. Recognizing these needs, the project will provide funding for strengthening of capacities of the FEPA.

6. Safeguard policies

Safeguard Policies Triggered by the Project	Yes	No
Environmental Assessment (OP/BP/GP 4.01)	[X]	[ ]
Natural Habitats (OP/BP 4.04)	[ ]	[X]
Pest Management (OP 4.09)	[ ]	[X]
Cultural Property (OPN 11.03, being revised as OP 4.11)	[ ]	[X]
Involuntary Resettlement (OP/BP 4.12)	[ ]	[X]
Indigenous Peoples (OD 4.20, being revised as OP 4.10)	[ ]	[X]
Forests (OP/BP 4.36)	[ ]	[X]
Safety of Dams (OP/BP 4.37)	[ ]	[X]
Projects in Disputed Areas (OP/BP/GP 7.60)[*]	[ ]	[X]
Projects on International Waterways (OP/BP/GP 7.50)	[ ]	[X]

7. Policy Exceptions and Readiness

The project does not require any exception from Bank policies. Assessments and preparation of fiduciary arrangements, staff and consultant selection, monitoring and evaluation systems and implementation and procurement plans meet the regional criteria for readiness of implementation.

[24] For instance, environmental management is gradually being integrated into the national policies for development in Ethiopia as outlined in the "Provisional Standards for Industrial Pollution Control in Ethiopia" (2003).

[*] *By supporting the proposed project, the Bank does not intend to prejudice the final determination of the parties' claims on the disputed areas*

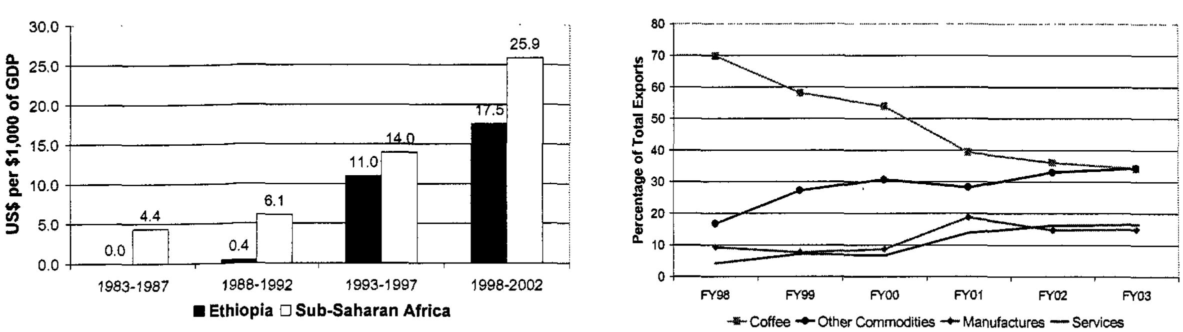
Annex 1: Country and Sector or Program Background
ETHIOPIA: Private Sector Development Capacity Building

The commitment of the Government of Ethiopia to reduce poverty through private sector-led economic growth is clearly outlined in the two documents prepared by the Government two years ago: a Sustainable Development and Poverty Reduction Program (SDPRP) and the Industrial Development Strategy. The key measures to achieve the overarching objective relate to structural and state transformation, including, *inter alia*, private sector development (PSD), non-traditional export growth, investment in capacity building of public and private sectors, improved governance and enabling environment for PSD. All the above are to bring an average GDP growth of 7 percent per annum and the poverty head count reduction by 10 percent by 2004/05.

Progress during the first two years of the SDPRP has been mixed. The economic growth during the 2002/03 was adversely affected by the combination of the worst drought to hit Ethiopia since 1984/85 and large declines in the terms of trade for key commodities, particularly coffee. As a result, agricultural production declined by 12.6 percent, GDP dropped by 3.9 percent, while the number of people threatened by starvation increased from 5 to about 13 million. The situation improved the following year, 2003/04, in which Ethiopia's GDP growth rebounded by close to 11.6 percent due primarily to the recovery of the agriculture sector, which grew by about 19 percent. There was also an increase in private sector activity with increased exports of non-factor services, a rebound in coffee earnings and increase in private investment as a share of GDP. The outlook for this fiscal year looks promising as the harvest is expected to be exceptionally good.

Despite these positive developments, Ethiopia remains one of the poorest countries in the world with a per capita income of US$100, 44 percent of its 70 million population living below the poverty line, a 58 percent illiteracy rate, and life expectancy of 42 years and falling in large part because of the HIV/AIDS pandemic. The Ethiopian economy is poorly integrated into the regional and international economy and it has not participated in the benefits of globalization. Ethiopia's record in attracting FDI has generally been weak, although it is slowly improving reaching $189 million in 2002/03. Nonetheless, comparing FDI inflows as a share of GDP, Ethiopia still lags behind the Sub-Saharan average by almost ten percentage points. This weak performance is even more evident taking into account a large "diaspora" which in the case of other countries often invest in their home country.

Figure 1: Ethiopia's FDI Inflows as Share of GDP and Composition of Export



Similarly, in spite of recent moderate growth, Ethiopia has not been able to reap the benefits of the rapid expansion of international trade over the last decade particularly in sectors where it has potential, such as non-traditional agricultural products, labor-intensive manufacturing activities, and tourism. This is especially disappointing given the availability of AGOA privileges in the apparel industry, a significant cost advantage for labor, and a substantial reduction in import protection (the weighted average tariff having fallen from $29 percent in 1995 to 17.5 percent in 2002). Export earnings are equal to only 16 percent of GDP, and the country continues to be heavily dependent on coffee, which accounts for some 40 percent of merchandise exports. On the positive note, however, the share of other merchandise in export is slowly increasing, which would indicate diversification of the economy (Figure 1). Exports amount to only $15 per capita, compared to $34 in Tanzania, $53 in Uganda, and $160 in Ghana. Ethiopia's manufactured exports amount to a meager 10 percent of the small export total. Of still greater concern, exporting Ethiopian firms account for less than 8 percent of the population of firms, which is very small by any standard (ICA).

The reasons contributing to this situation are manifold. Among the most important impediments to economic diversification and private sector growth is low level of firms' productivity resulting from weak competition and a dominant position of public sector in almost every aspect of the economy. This situation has been exacerbated by a slow pace of privatization program over the past two years. Weak capacity in the private sector (both, firms and institutions) and in government institutions that regulate or provide services to the private sector, further impede the private sector participation in economic activities. Finally, Ethiopia may still suffer from lack of business confidence, which results partly from the problems of the recent past related to the war and recession.

Public enterprises (PEs) dominate the economic landscape of Ethiopia. All the utilities are state monopolies.[25] Financial institutions, including the banking and insurance sector, are also under the state monopoly or extended control. The banking sector is dominated by three state-owned banks, which account for 66 percent of branches, 75 percent of total capital, 57 percent of savings and 34 percent of loans. Private sector participation in the manufacturing sector is very low (Table 2), especially in sectors such as wood, construction services, and basic iron and steel. Public sector involvement is also significant in the sectors considered as potential sources of growth and the best candidates for private investment - food and beverages, leather and leather products and textiles and garments sectors – which is inheritance from the past socialist regime.

Table 1: Percent Share of Public Manufacturing Enterprises in Selected Sectors

Sector	Share of Enterprises	Share of Employees	Share of Wages/salaries	Share of census value added
All sectors	15.2	64.2	62.1	72.2
Highest three sectors	Wood 38.1	Wood 78.1	Wood 89.0	Wood 93.8
	Textiles and Garments 35.4	Construction materials 73.9	Construction materials 83.7	Construction materials 91.9
	Chemicals and Vehicle 28.6	Basic Iron and Steel 70.9	Basic Iron and Steel 75.2	Pharmaceutical 69.6
Lowest three Sectors	Furniture 3.38	Furniture 7.1	Furniture 11.6	Furniture 7.1
	Rubber and Plastics 5.1	Vehicle and Parts mfg and assembly 33.3	Chemicals 9.0	Vehicle and Parts mfg and assembly 18.0
	Fabricated metal including m/c 7.3	Rubber and Plastics 35.2	Vehicle and Parts mfg and assembly 50.0	Basic Iron and Steel 23.8
Other sectors				
Food and beverages	15.3	57.8	64.8	71.7
Leather and leather products	21.0	73.8	83.5	91.9
Textiles and garments	35.4	66.3	67.2	63.9

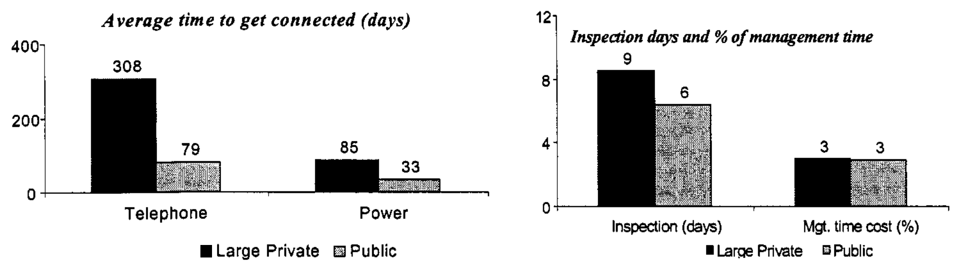
Source: based on CSA Survey data

[25] Ethiopia Telecommunication Company (ETC), Ethiopia Electricity and Power Company (EEPCo), Ethiopian Airline (EAL), Ethiopia Railway Corporation (ERC).

In addition to a highly monopolistic structure of the economy, with state-run or controlled enterprises in many sectors, there are also, so-called, foundation enterprises associated with the political parties within the current ruling coalition operating in many commercial activities (UNCTAD). Data on the size of the turnover of these firms relative to the size of the rest of the private sector, their competitiveness and profitability are not available. Nonetheless, these firms have important financial resources, allowing them to take a long-term view and grow in spite of the adverse business environment.

This hypothesis of uneven playing field between the private and the public sector firms seems to be confirmed by the results of ICA (2002) and its update (2004). PEs seem to have easier access to physical infrastructure and enjoy faster administrative services (see Figure 2 below). For instance, the average time to get a landline for a private firm is four times longer that for a PE. The difference is twofold for getting access to grid power. PEs have to deal with regulatory inspections less than large private firms. Further, analysis of the CSA Survey also seems to confirm that PEs have the opportunity to delay interest charges, while private sector enterprises may not enjoy similar treatment.

Figure 2: Evidence for Lack of Level Playing Field in Ethiopia

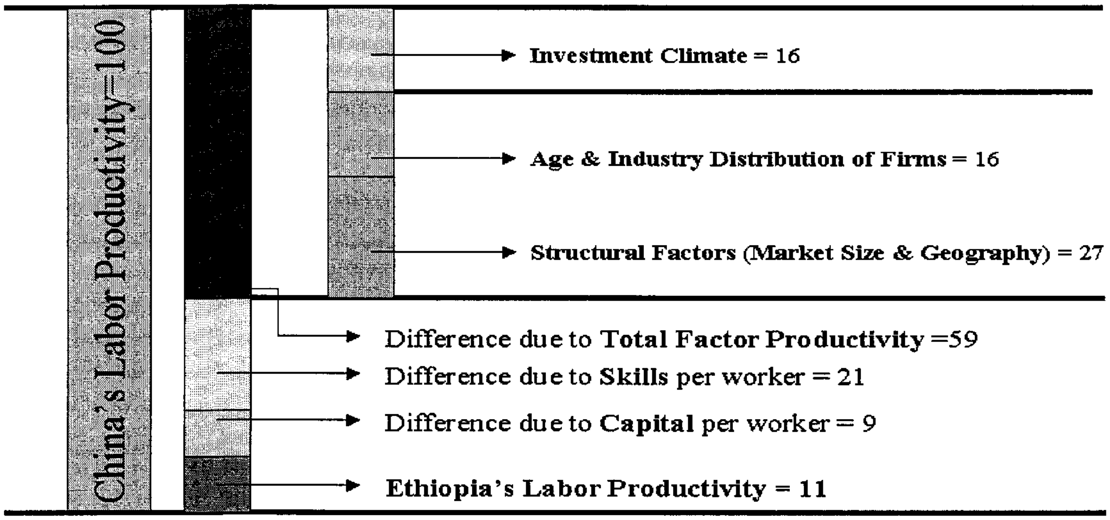


Poor export performance of the Ethiopian economy is also a result of problems Ethiopian firms face on price/cost competitiveness, quality of products, and timeliness/costs of product delivery. The results of ICA clearly show that productivity and competitiveness of SMEs in Ethiopia are among the key contributing factors: average labor productivity in Ethiopia is only about 80 percent that in Bangladesh and one-tenth that of China. The reasons for Ethiopia's labor productivity shortfall are manifold and decomposition of labor productivity into its major components (skills, capital, geography, investment climate, firm size) reveals the importance of each component (Figure 3).

The largest component of the labor productivity gap is the difference in total factor productivity, which explain 59 percent of the shortfall. Total factor productivity can be decomposed into (i) structural factors (geography, market size), which account for 27 percent of the difference between Ethiopia and China and which would take a long time to change; (ii) the age and industry distribution of firms, which explain 16 percentage points of the difference in productivity, which are endogenous and can change in the medium term in response to incentives; and (iii) objective investment climate indicators (power outages, overdraft facilities, customs clearance), which account for another 16 percentage points of the shortfall, which can be affected in the short to medium term by good policies and public investment. The investment climate is thus as important as the age and industry distribution of firms and more important than differences in capital.

However, the second largest contributor to the productivity gap is differences in skill levels, as measured by differences in years of schooling, which explains the largest share of the gap (21 percentage points). Indeed, according to the EDRI survey of micro and small enterprises (2004) nearly 90 percent of the operators did not receive any pre or post vocational or technical training. For these reasons, capacity building (CB) is of critical importance for Ethiopia to meet its growth and poverty reduction objectives.

Figure 3: Components of the Labor Productivity Gap between Ethiopia and China



Problems with the quality/design of products can be partially attributed to the almost complete absence of business development services (BDS). Currently, CB for the individual firm consists mainly of open training courses and limited assistance with business planning supplied by public-sector entities at highly subsidized fee rates. As a result, private supply of BDS's has barely started to develop. Lack of BDS services facilitating knowledge and technology transfer severely limits the potential of firms to enter and compete in the international and regional markets.

Finally, institutional support to PSD is also weak. The network of chambers of commerce, headed by the Ethiopian Chamber, is the main channel by which private sector interests are represented, both in the formulation of new GOE policies, and in dealing with problems in the implementation of policies. The chamber movement, although in receipt of various forms of donor support, still lacks the capacity to fully represent its members in the dialogue with GOE. Most of the industry-specific and professional associations are relatively new, inexperienced and unclear about their role; have low membership penetration and few services of real benefit to members, thus insufficient fee income. Generally, members do not yet place a high value on advocacy. Few associations spend time and resources on preparing their advocacy with professionally-prepared submissions or proposals. Although a recently formalized PPCF is gaining momentum, Associations are yet to establish their role in participating and channeling dialogue between their members and the Government. Associations have not yet established good links with international networks, so as to learn from experiences elsewhere on how to develop creative new income-generating services, and how to increase membership penetration. A very similar pattern exists in professional institutes and associations. Regulation of the professions is still done by government. But it is clear that the Government is open to moving to self-regulation, for instance, for consulting engineers. The association representing this profession, however, has so far been too weak and under-funded to be able to respond effectively to this important opportunity.

Annex 2: Major Related Projects Financed by the Bank and/or other Agencies

ETHIOPIA: Private Sector Development Capacity Building

No.	Project	Rating	Status	Sector Issues Covered
BANK FINANCED				
1.	PRSC1, P074014, H0730 IDA	S	On going 2/2004 – 12/2004	PRSC I supports the implementation of Ethiopia's Poverty Reduction Strategy (the Sustainable Development and Poverty Reduction Program) 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; and improving the investment climate (including for the rural sector).
2.	PRSC2, PO77749, 51119 JPN		On going	The proposed Grant would support implementation of key SDPRP reforms to: (i) improve the investment climate; (ii) improve governance and service delivery; and (iii) reduce vulnerability.
3.	Public Sector Capacity Building Project (PSCAP) P074020, Q3710	S	On going 7/2003 – 11/2004	The objective of the project is to improve the scale, efficiency, and responsiveness of public service delivery at the federal, regional, local level services; empower citizens to participate more effectively in shaping their own development; and promote good governance and accountability. This objective will be achieved by scaling up Ethiopia's ongoing capacity building and institutional transformation efforts in six priority areas (i) Civil Service and Expenditure Management Reform; (ii) District-Level Decentralization; (iii) Urban Management; (iv) Tax Systems Reform; (v) Justice Systems Reform; (vi) Information and Communications Technology
4.	Road Sector Development Phase II Project (APL2) P044613, 50518 JPN	S	On going 8/2002 – 12/2004	The proposed Grant would help the to: a) rehabilitate and upgrade of federal trunk and link roads; b) construct federal link road; c) support the implementation of the rural travel and transport program of the recipient; d) strengthen project implementation; (e) strengthen project accountability mechanisms; and f) support the accomplishment the program's objectives.
5.	Information Communication and Technology Assisted Development Project (ICTAD), P078458, 51627 JPN		9/2002 – 3/2004	The proposed Grant would help the to: a) rehabilitate and upgrade of federal trunk and link roads; b) construct federal link road; c) support the implementation of the rural travel and transport program of the recipient; d) strengthen project implementation; (e) strengthen project accountability mechanisms; and f) support the accomplishment the program's objectives.
6.	Energy Access Credit , P077380, 51306 MULT			The project has the following four objectives: (i) Establishment of a sustainable program for expanding the population's access to electricity; (ii) Reduction of environmental degradation and improve energy and use efficiency; (iii) Removal of the barriers to the wide spread adoption of renewable energy technologies; and (iv) Provision of technical support for institutional and capacity building to key sector institutions.

No.	Project	Rating	Status	Sector Issues Covered
7.	Water and Sanitation Project	S	Ongoing 03/2004	Increased access to sustainable water supply and sanitation services, for rural and urban users, through improved capacity of stakeholders in the sector.
OTHER AGENCIES				
1.	Support to Micro-Finance Institutions Dev. Coop Ireland		On going 2001-04	Capacity building for AMFI, training of bank officials, capital for equipment., performance monitoring systems
2.	Practical support to the horticulture sector, DFID		On going 2002-04	Producers and Exports
3.	Economic Partnership Agmt with EU			EPA Impact Assessment Study
4.	Trade Capacity Building , EC			Ministry of Trade and Industry
5.	Small Micro Enterprises Dev. Program, EC, GTZ and Italian Coop.			
6.	Ethio-German MSE Dev. Program, GTZ		On going 1996-05	Support institutions, chambers, associations
7.	Privatization Support, GTZ		On going 1999-06	Advisory services to Ethiopian Privatization Agency
8.	Micro and SME Development, EC, Italian Coop.		On going 2003-05	Manufacturing business and tourism
9.	Support Leather and Leather product raining institute, Italian Coop.		On going 2001-05	Sector Training
10.	Textile Manufacturing Industry, Italian Coop.		On going	Textile Business
11.	Provision of Arbitration Center, Netherlands Embassy		On going 2001-04	Arbitration center at Addis Ababa Chamber of Commerce
12.	Establishment of Savings and Credit Co-ops, USAID		2004	Small scale producers of coffee, cereal, vegetables, dairy
13.	Good Governance and Investment Promotion and Facilitation (GGIP), UNCTAD (with Swedish Govt)		2004	Ethiopian Investment Commission
14.	Windows II projects (3 total), UNDP on behalf of IF			Institutional support and trade related assistance,

Annex 3: Results Framework and Monitoring

ETHIOPIA: Private Sector Development Capacity Building

PDO	Outcome Indicators	Use of Outcome Information
Create improved conditions for private sector investment and increased productivity.	1. Increased private investment to GDP ratio from 10.5 percent in 2003/04 to 15 percent in 2009 (including privatized firms). 2. 4,500 new jobs created in the private sector by project end. 3. Value added per worker increased by 20 percent in participating firms by project end.	YR2 Assess progress towards achieving PDO and revise component strategies as needed YR5 Evaluate project success; assess relative effectiveness of various components to inform future Government policy formulation and programs
Intermediate Results One per Component	**Results Indicators for Each Component**	**Use of Results Monitoring**
Component One: Accelerating the Implementation of Privatization Program Result: Implementation of the Privatization Action Plan completed	**Component One:** 1. 27 percent by YR3 and 55 percent by YR5 of PE portfolio scheduled for privatization in terms of total value of assets transferred from the public to the private sector.[26]	**Component One:** YR1-YR2 Measure the results to determine if changes are necessary; feed lessons into the remaining of the program; trigger additional funding from other donors for redundancy, if required. YR3-YR5 Monitor progress towards targets
Component Two: Improving the Business Environment through Implementation of Competition Policy and Accession to WTO Result: Improved business environment and competition policy under effective implementation	**Component Two:** 1. By YR2 issuance of interpretations/implementation guidelines 2. 4-6 cases in YR1-2 and 6-10 cases in YR3-5 handled by the Competition Commission 3. 4 public information programs per year conducted as a measure of 'competition advocacy' 4. 4 of trade related studies completed and disseminated	**Component Two:** YR1-YR2 Measure the results to determine if changes are necessary; feed lessons into the remaining of the program. YR3-YR5 Monitor progress towards targets

[26] An enterprise will be deemed to have been privatized when its ownership or control of the business has been transferred to the private sector. This will apply regardless of the method of privatization used to transfer control. One hundred percent of the assets of any enterprise deemed to have been privatized will count as having been privatized for the purpose of evaluation and performance monitoring. Control of a business will be deemed to have been transferred to the private sector if either: (i) The government owns less than 50 percent of the shares of the business (including liquidation), or (ii) Management of the business has been transferred to the private sector by way of a contract. The contract can be either a management contract of three to five years, renewable, or through a long term concession or lease. Where transfer of control is by way of contract, should the contract expire or be cancelled, the enterprise will no longer be deemed to have been privatized.

Component Three: Strengthening the International Competitiveness of the Private Sector and the Capacities of its Representative Organizations	**Component Three:**	**Component Three:** YR1-YR2 Measure the results to determine if changes are necessary; feed lessons into the remaining of the program. YR3-YR5 Monitor progress towards targets
Results for BIZCAP Increased firms' ability to compete and stronger institutions supporting PSD	1. Supported exporters increase their exports at a rate 25 percent higher than non-supported firms. 2. Supported domestic market suppliers increase their sales at a rate 25 percent higher than non-supported firms. 3. Supported chambers and associations increase their memberships (number of members) at a rate 25 percent higher than do non-supported associations.	
Results for SCHOOLCAP: Improved business management education	1. Academic Upgrade of Curriculum: (i) Y1- revised program syllabus; updated annually; (ii) at least two new courses in Y1 and at least one new course annually. 2. Resource Upgrade for Curriculum: 10 percent pa increase of Ethiopians in faculty qualified to teach at graduate level each year. 3. National skills training: (i) At least 30 Ethiopians trained from at least five institutions every year; (ii) at least 20 percent increase in subscribers annually for the AAU Journal. 4. 25 students per year that completed each course on trade and competition policy	
Result BIZPLAN: Increased number of private firms with established relationship with the private banks	1. At least 250 eligible entrepreneurs apply to BIZPLAN competition in first year, with at least 10 percent increase in number of eligible applicants annually.	

Arrangements for results monitoring

			Target Values				Data Collection and Reporting		
Outcome/Impact Indicators	**Baseline**	**2005**	**2006**	**2007**	**2008**	**2009**	**Frequency and Reports**	**Data Collection Instrument**	**Responsibility for Data Collection**
1. Increased private investment to GDP ratio from 10.5 percent in 2003/04 to 15 percent in 2009 (including privatized firms).	10.5%	11.5%	12.5%	13%	14%	15%	Annual	PSD annual report Ministry of Finance annual report	PCU Statistic Dept.
2. 4,500 new jobs created in the private sector by project end	tbd			2,500		4,500	Annual	PSD annual report Ministry of Finance annual report	PCU Statistic Dept.
3. Value added per worker increased by 20 percent in participating firms by project end	tbd	3%	8%	13%	17%	20%	Annual	MGS tracer studies ICA	PCU EE BMU

Results Indicators	Baseline	Target Values					Data Collection and Reporting		
		2005	2006	2007	2008	2009	Frequency and Reports	Data Collection Instrument	Responsibility for Data Collection
COMPONENT ONE: ACCELERATING THE IMPLEMENTATION OF PRIVATIZATION PROGRAM									
1. Implementation of the privatization plan completed									
1.1. 55 percent of assets of selected PE transferred to private sector	tbd	7%	16%	27%	40%	55%	Annual	EPA annual report	PCU PPESA
COMPONENT TWO: IMPROVING THE BUSINESS ENVIRONMENT THROUGH IMPLEMENTATION OF COMPETITION POLICY AND ACCESSION TO WTO									
2. Improved business environment and competition policy under effective implementation									
2.1. Interpretation/implementation guidelines issued by 2006			Yes				Annual	MOTI annul report	PCU Competition Secretariat
2.2. Number of cases resolved by the Competition Commission	Zero	4-6	4-6	6-10	6-10	6-10	Annual	Project management report Supervision	PCU Competition Secretariat
2.3. Number of public information programs conducted as a measure of 'competition advocacy'	Zero	4	4	4	4	4	Annual	Project mgt. report Supervision	PCU Competition Secretariat
2.4. Number of trade related studies completed and disseminated	-		1	1	1	1	Annual	Project mgt. report Supervision	PCU WTO Department
COMPONENT THREE: STRENGTHENING THE INTERNATIONAL COMPETITIVENESS OF THE PRIVATE SECTOR AND THE CAPACITIES OF ITS REPRESENTATIVE ORGANIZATIONS									
3. BIZCAP - Increased firms' ability to compete and stronger institutions supporting PSD									
3.1. Supported exporters increase their exports at a rate 25 percent higher than non-supported firms by project end.	Tbd			25%		25%	Annual	MOTI Annual report	MOTI EE BMU PCU

Results Indicators	Baseline	Target Values					Data Collection and Reporting		
		2005	2006	2007	2008	2009	Frequency and Reports	Data Collection Instrument	Responsibility for Data Collection
3.2. Supported domestic market suppliers sales increased by 25 percent higher than non supported firm by project end.	Tbd			25%		25%	Annual	MOTI Annual report	MOTI EE BMU PCU
3.3. Supported chambers and association of trade membership increased at a rate 25 percent higher than non supported ones by project end.	Tbd			25%		25%	Annual	MOTI Annual report	MOTI EE BMU PCU
4. SCHOOLCAP - Improved business management education									
4.1. Program syllabus revised and approved by the faculty curriculum evaluation standards committee in year one and updated annually		Yes	Yes	Yes	Yes	Yes	Yes	Project mgt. report Supervision	FBE PCU
4.2. At least two new courses in year one and one new course in annually thereafter		2 c	1c	1c	1c	1c	1c	Project mgt. report Supervision	FBE PCU
4.3. At least 10 percent increase of ET in faculty qualified to teach at graduate level each year	57%	63%	69%	76%	83%	91%	Annual	Project mgt. report Supervision	FBE PCU
4.4. At least 30 Ethiopian trained from at least five institutions and 10 percent increased annually		30	33	36	40	43	Annual	Project mgt. report Supervision	FBE PCU
4.5. Publication of journal as well as at least 20 percent increased subscriptions annually	Tbd	20%	(1+x1)20%	(1+x2)20%	(1+x3)20%	(1+x4)20%	Annual	Project mgt. report Supervision	FBE PCU

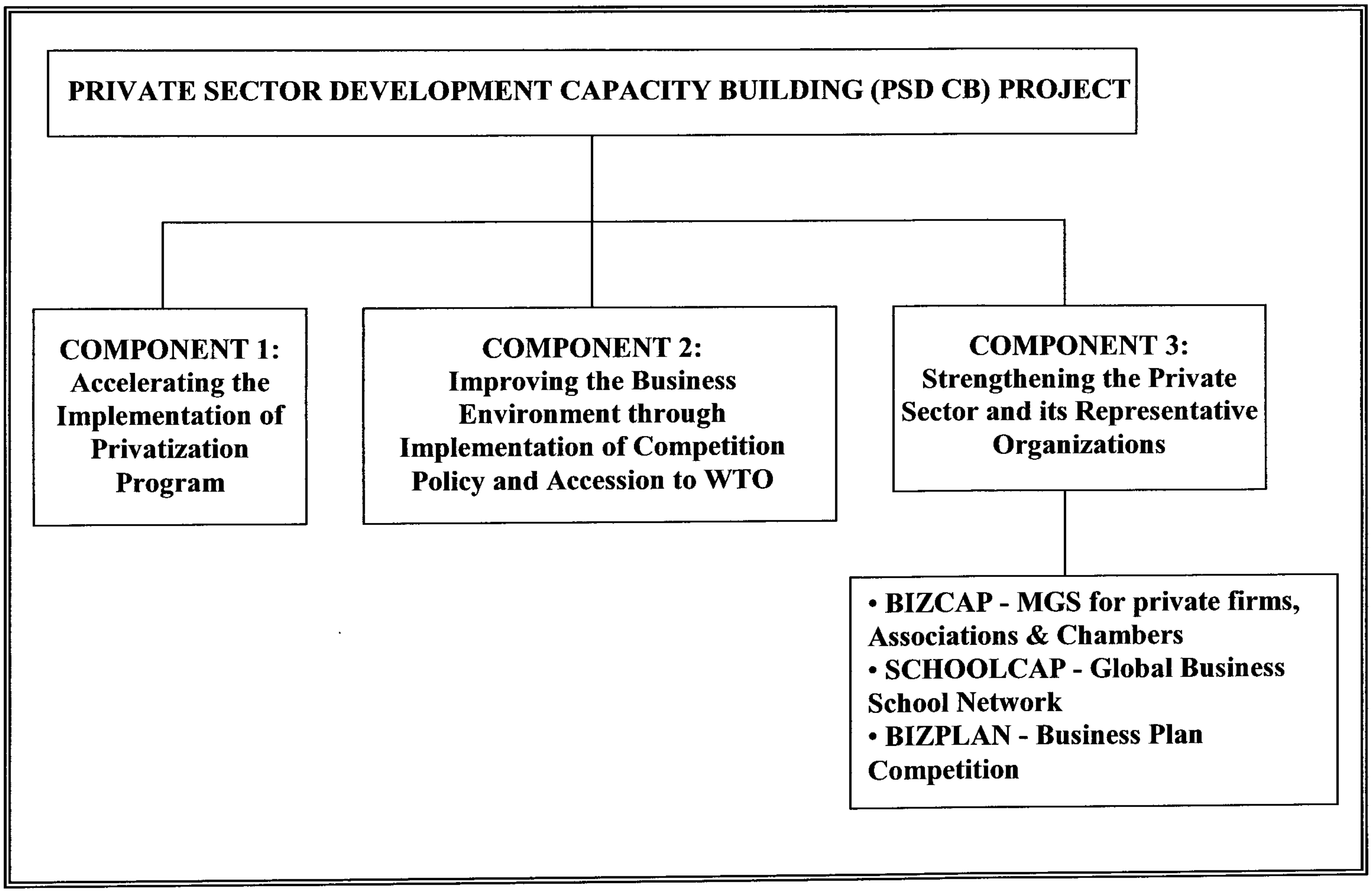
Results Indicators		Target Values					Data Collection and Reporting		
	Baseline	2005	2006	2007	2008	2009	Frequency and Reports	Data Collection Instrument	Responsibility for Data Collection
4.6. 25 students per year that completed each course on trade and competition policy	Zero	50	50	25	25	25	Semester	Project mgt. report Supervision	FBE PCU
5. BIZPLAN - Increased number of private firms with established relationship with the private banks									
5.1. At least 250 eligible entrepreneurs applied to BIZPLAN competition in 2005 and 10 percent incremental annually		250	275				Annual	Project mgt. report Supervision	MOTI PCU EE BMU

*Baseline data will be determined the first year of project implementation through data collection by PCU.

Annex 4: Detailed Project Description

ETHIOPIA: Private Sector Development Capacity Building

Figure 4: PSD CB Project Components and Sub-components



COMPONENT ONE - ACCELERATING THE IMPLEMENTATION OF PRIVATIZATION PROGRAM (IDA US$9.87 million, of which US$5 million is an IDA grant)

Issues:

In February 1994, the GOE started implementing a Privatization Program by establishing the Ethiopia Privatization Agency (EPA) under Proclamation number 87/1994, later amended in 1998. At that time, Ethiopia had 212 Public Enterprises (PEs), including those nationalized by under the DERG[27] regime. Privatization commenced in 1995 with the sale of small retail outlets and medium sized hotels and restaurants, unbundled from over 12 PEs. The bulk of sales consisted of small trading outlets and hotels and restaurants – of the 214 PEs sold to date, 152 were unbundled from six enterprises: two retail and four hotels.

Analysis of progress of the privatization program shows that there was high activity in the first wave of the program, which peaked in 1996-1997 and then declined and nearly stopped in 2003. Over the past two years, over 41 PEs where tendered but not sold, while 59 were under preparation for sale under EPA as at end 2003, indicating that the privatization program has not been performing in accordance with the Government's expectations. Beginning in 2003, and with a view to exploring other modalities of divestiture, the Government entrusted the Public Enterprise Supervision Authority (PESA) with the task of using public-private participation approaches (including joint ventures, concessions, leasing, management contracts, etc.) to accelerate the program. To date, PESA has successfully completed 3 Joint Ventures out of a call for interest for over 100 enterprises.

Table 2: Shortcomings of the Privatization Process in Ethiopia

Institutional aspect. A number of institutions were involved in the implementation of the privatization program: the EPA and PESA under MoTI (moved from the Prime Ministers office), Board of Trustees (BoT) under the Ministry of Finance (MoF), with PE supervision split between PESA, BoT, MoF (banking sector) and Basic Metals and Engineering Agency (Metal PEs). Privatization is handled by EPA and PESA with no clear demarcation of mandate. As a result, there were cases of the same enterprise being marketed simultaneously for different privatization methods resulting in confusion in the market. Further, the privatization process has been conducted by relatively poorly staffed individual teams that appear to operate in isolation.
Procedures. The divestiture process involves preparation, evaluation, tendering and closure of sale followed by post divestiture monitoring. This process has, in many cases, taken up to three years. Of the 41 PEs tendered, but as yet unsold, a large number will have to go through the process of re-evaluation, which will add to this timeframe. Further, during the process of tendering and evaluation, the EPA Board set a high reserve price that did not take into consideration the market. As a result, re-tendering of the PEs has often been necessary, and this has frequently not resulted in successful sales. Additionally, the marketing of enterprises has been ineffective; the PEs are by and large marketed only locally, with limited international outreach.
Labor and land issues. Labor restructuring has not been undertaken by the Government prior to sale and remains a responsibility of the investor within the constraining framework of the current Labor Laws and practices. Secondly, the investor is expected to resolve the land issues separate from the sale with the regional authorities, which seems to have been a constraint in a number of cases.

The reasons for the slow performance of the privatization program have been analyzed in various studies, including the recent GTZ study on investor interest,[28] and ADB mission reports. The most important constraints pertain to institutional aspects, procedures governing the process and the inclusion of labor and land issues as a part of the privatization transaction. As a first step to address these shortcomings, the Government has merged the two institutions thus far responsible for the privatization program into one

[27] ADB Special Country Report # 5: Private Sector Development in Ethiopia and the Role of ADB.

[28] Study on Low Investors' Interest in Ethiopia and Institutional Support of EPA (July 2003) and a follow-up position paper on the Ethiopia Privatization Program.

called the Privatization and Public Enterprise Supervisory Authority (PPESA) with a view to coordinating the implementation of the privatization program with the activities of supervising public enterprises.[29] Further, the Government has also prepared a Privatization Action Plan, geared towards accelerating the privatization program and addressing the issues of labor redundancy. To achieve these objectives, the Government intends to make use of a range of divestiture modalities including asset sale, concessions, leasing, joint ventures, management contracts, etc. The Government will adopt process-driven procedures in transactions using a market-oriented, open, transparent and competitive bidding process. Further, in order to address concerns of potential investors related to labor issues, the divestiture process will allow the successful bidder flexibility to restructure the labor force of the enterprise. To mitigate the social impact of possible redundancies that may result, the Government will develop and implement a retrenchment program. For the Government to succeed with the implementation of its Privatization Program there is an urgent need for technical and financial assistance to enable the Government to conduct the divestiture process in most efficient, open and transparent manner and to address issues of labor redundancy that may result from the privatization process.

Activities: Since the ADB is also providing funds to PPESA, the activities to be funded by IDA have been designed to complement those which are expected to be financed by ADB. Activities to be funded by the project are:

- *(i)* Institutional capacity building of PPESA
- *(ii)* Transaction advisory services
- *(iii)* Environmental audits
- *(iv)* Retrenchment program
- *(v)* Studies

1. INSTITUTIONAL CAPACITY BUILDING OF PPESA

This activity will cover training of the PPESA staff and board members with a view to enhancing their capacity to effectively implement the program. An enhanced information system, building on the existing systems that were in use in PESA and EPA, will also be designed and implemented.

1.1 Training (US$150,000)

Based on training needs assessed through a study to be funded by the ADB, this activity will fund the costs of the approved training interventions. The staff and board of the new PPESA have identified a range of training needs to enable them carry out their new expanded mandate. Training is likely to cover topics such as negotiating skills and contract management. Both in-house group training and individual training, as needed, will be provided.

1.2 Information Systems (US$150,000)

Before the merger, both the EPA and PESA had independent databases and information systems which need to be integrated and upgraded for use by PPESA. This upgraded system will include a detailed PE monitoring and evaluation system for the PPESA to provide timely and accurate information.

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[29] The proclamation establishing the Privatization and Public Enterprises Supervising Authority (PPESA) was gazetted on 2, August 2004. As a result, PPESA effectively amalgamates the Ethiopian Privatization Agency (EPA) and the Public Enterprises Supervising Authority (PESA). As a first step in operationalizing the new institution, the Director General and deputy Director have been appointed. The physical merger, complete with the implementation structure, is being finalized.

(i) *System integration and enhancement.* This activity will fund the cost of a short term consultant to assist with the development and implementation of an integrated and enhanced management information system for PPESA. The enhanced system will include document archiving and retrieval and will be designed to facilitate the efficient operation of the entire authority, particularly the PE and contract monitoring systems being developed by this project and the ADB. Training in the use of the new system will be included under the training activity above.

2. TRANSACTION ADVISORY SERVICES (US$1.5 million)

Government has provided an indicative list of 55 PEs (see Annex 10, Table 3) for which the project will provide transaction advisory support and which will be divested by the end of the project. In a bid to accelerate and enhance the privatization program, PPESA will utilize the services of transactions advisers at various stages of the process to achieve better value, particularly through better packaging and marketing of the enterprises being privatized. The activities funded by the project will compliment the work of the long term adviser to be financed by DFID.

For large and complex transactions this activity will fund the services of transaction advisers as and when needed. The advisers will be selected and contracted by PPESA and will report, in the first instance, to the team leader within PPESA responsible for the transaction. Advisers will be contracted to work on one or a group of enterprises and PPESA will use their services at selected stages of the transaction. The transaction assistance may include performing seller's due diligence, preparing all the necessary documentation, organizing the tendering process, marketing the enterprise and identifying potential investors, supporting the negotiations with the preferred bidder, and assisting with the closing of the transaction.

3. ENVIRONMENTAL AUDITS (US$900,000)

Additional advisers will be required to undertake total or partial environmental audits on selected enterprises from the whole portfolio of enterprises slated for privatization . An environmental pre-audit, funded through the PHRD grant, was undertaken for 155 enterprises under PPESA. The study identified 24 enterprises requiring full environmental audits, 72 for partial audit, and the rest requiring no further work. For those enterprises identified for full or partial audit this activity will fund the required environmental studies. Environmental Management Plans will also be prepared as part of the environmental study where necessary. These will assist PPESA and FEPA in negotiating compliance agreements with new investors where PEs do not meet existing standards at the time of their privatization.[30]

4. RETRENCHMENT PROGRAM

Public enterprises are frequently over staffed and new investors usually wish to take over only a portion of the existing employees of an enterprise. Making workers redundant commonly leads to opposition to the privatization process, particularly from the employees themselves. To ameliorate the social impact of possible labor redundancies the Government will develop and co-fund with investors a voluntary separation package The package would offer a portfolio of benefits in addition to those provided under law or collective employment agreements. The portfolio, which will be determined by a study, would include options such as early retirement as well as options for retraining, counseling, employment outreach services and assistance with starting up new private sector enterprises. The project will fund two activities: the cost of a labor market expert to design the voluntary separation package (including the

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[30] If required, the project will fund a training needs assessment of the FEPA and its implementation to build its capacity.

exact formula) as well as a share of costs for implementation of the initial phase of the redundancy program.

4.1 Design of the retrenchment program (US$120,000)

The project will fund the cost of a labor market expert to design the retrenchment policy. It is the intention of the Government to implement the voluntary redundancy package on a 50/50 cost-sharing basis with the potential investors.

The consultant will be required to make a preliminary estimate of the number and age profile of the employees of each enterprise scheduled for privatization that may be made redundant at the time of privatization and the likely costs of implementing the agreed program, range of benefits that should be offered to employees and exact formula. The total labor force in the public enterprises scheduled for privatization is approximately 80,000, of which a significant proportion would be eligible for early retirement. According to the existing legal framework, separation benefits are low and amount to one month per year up to a cap of one year's salary. It is expected that the proposed separation package would provide more generous benefits to a maximum of 3 months salary per year of service, capped at US$ 2,000, which is equivalent of 20 times GNP per capita. The cap will be finalized based on the results of the study.

The consultant will also be required to make recommendations on how the program should be implemented, including funding options and the institutional arrangements for managing the program, which may include contracting out to the private sector or management by a small secretariat housed within PPESA or an appropriate government department. The actual provision of services such as retraining and counseling may be contracted out to private sector providers.

4.2 Funding of retrenchment program (US$7 million)

As noted above, the Government proposes meeting half of the cost of the package offered to employees made redundant as a consequence of privatization. IDA funding will provide up to US$ 7.0 million (of which US$5.0 million is a grant) towards the costs of implementing this program in a manner consistent with policies of the Association, including policies that bear on the financing of severance pay. The total US$14 million of funding for retrenchment program covers the initial phase. Additional funding for any subsequent phases will need to be sought from the privatization proceeds and/or other donors; there will be no reallocation of IDA proceeds to this component. Further, it has been agreed that the Government will fund the cost of the secretariat or other agency that will implement and manage the redundancy and social safety net programs as well as any redundancies required as part of any restructuring of enterprises undertaken prior to privatization.

5. STUDIES (US$50,000)

To ensure adherence to privatization contracts, it is necessary for PPESA to have in place a mechanism to monitor compliance by investor with contract covenants. The project will fund the cost of a short term consultant to assist in the development and implementation of the monitoring system. This work will need to be coordinated with the work being undertaken on the enhancement of the IT system and the work being funded by the ADB on post privatization monitoring.

COMPONENT TWO - IMPROVING THE BUSINESS ENVIRONMENT THROUGH IMPLEMENTATION OF COMPETITION POLICY AND ACCESSION TO THE WTO (IDA US$1,350,000)

Subcomponent A – Implementation of Competition Policy (IDA US$450,000)

Issues:
As part of its strategy to foster broad based and sustainable private sector-led economic growth and poverty reduction, the Government plans to develop an effective competition policy framework. The aim of this policy would be to maintain and encourage competition in the domestic economy in order to promote economic efficiency, competitiveness, and consumer welfare. Additionally, the policy will aim at ensuring a 'level playing field' between PEs, 'party affiliated' companies, and private sector firms; eliminating or lowering unnecessary regulatory and other policy-based barriers to entry; preventing anticompetitive and monopolistic business practices; and broadening the opportunities for new Ethiopian investors and entrepreneurs to participate in their own economy by increasing accountability and transparency in government-business relations.

In April 2003, the GOE enacted the Trade Practices Proclamation (TPP). It contains articles against collusive behavior (such as agreements between competing firms to fix prices, allocate markets or customers and bid-rigging), and abuse of market position by dominant firms (such as predatory pricing and market foreclosure). It also has measures against various types of other unfair trade practices (such as misleading advertising and tied selling). However, the TPP does not have provisions for 'competition advocacy', which is relevant for reviewing public policy impediments to competition and regulatory reform. It also does not have provisions against mergers and acquisitions--particularly relevant for the government's privatization program if creation of new monopolies is to be prevented. To enforce existing provisions, and develop new measures and policies, the newly-established Competition Commission and Secretariat will need expert technical advice and training to build capacity. Absence of such support poses the risk that the TPP will not be effectively applied, and that the development of the nascent private sector (which mainly comprises of SMEs) will be impeded. The large PEs and 'party-affiliated' firms – some already noted for their anticompetitive business practices – will undoubtedly attempt to further entrench their market position.

Activities:
The following activities will be funded under this Sub-Component:

(i) *Preparation of Implementation Guidelines and Regulations.* This activity will support preparation of the interpretation guidelines, regulations, procedures, methods and manuals relating to various provisions of the Proclamation. This includes administrative procedures for handling complaints, selecting cases, conducting investigations, gathering evidence, protecting business confidentiality, measures safeguarding the rights and obligations of different parties involved in competition cases, remedies and fines, examination of widespread anticompetitive business practices and industry specific situations, engaging in 'competition advocacy' and other matters deemed necessary for the effective implementation of competition law-policy. TA will be funded to provide support for the review, evaluation, and amendments to the law in order to harmonize it with international best practice.

(ii) *Staff Capacity and Institution Building.* The component will fund the provision of short term visiting international experts/advisers to provide advice and materials on case specific matters, investigative techniques, evaluating evidence, conduct staff training workshops and public information dissemination programs. It also provides for attendance by staff of short-medium term educational courses. This component will help to develop the skills and capacity of the

Commission and the Secretariat in concepts and methods used to select cases, conduct investigations, gather and interpret evidence, safeguard confidential business information, prepare case and sector specific analyses, recommend remedial actions, fines and other measures to address anticompetitive business and unfair trade practices. Finally, to enhance understanding of the Trade Practices Proclamation, foster greater accountability and transparency, and build support for competition law and policy, the component will support workshops, conferences, preparation of supporting materials and publications to disseminate information so as to build consensus and support for the Government's competition law-policy framework. .

(iii) *Materials.* This will include upgrading resource materials, e.g., books, articles, journals, and any other materials deemed necessary for the members and staff of the Competition Commission-Secretariat and MOTI to perform their work and duties effectively.

Sub-Component B – Support to WTO Accession (IDS US$650,000)

Issues:
Ethiopia has made important progress in liberalizing its economy but it remains relatively closed in comparison with other, well-performing countries in sub-Saharan Africa. The GOE is committed to a second generation of reforms but it is confronting some difficulty in building a consensus around the appropriate path and in dealing with the vested interests at stake. Accession to the WTO can serve as a key focal point for reforms, providing a goal for which there is generally broad agreement, and a process and timetable, which maintains the momentum for reform.

Membership in the WTO is generally understood to be essential for any country hoping to be a full participant in the global economy, and accession by Ethiopia will send a strong signal to the international trade and investment community that the country is indeed open for business. WTO accession will require further liberalization in various sectors, opening up new opportunities for private investors as well as improving the services offered to consumers. It will also necessitate improvements in trade-related institutions in the areas of customs, intellectual property rights and product standards. Equally important, the WTO serves as a useful lock-in mechanism to ensure that there is no slippage in the reforms undertaken, a phenomenon which is all too familiar in other African countries.

The GOE has had observer status at the WTO for more than five year. It has now decided to formally launch the accession process with the preparation and submission of the Memorandum on the Foreign Trade Regime. This document outlines in some detail the country's entire trade regime, including all constraints to foreign participation in every sector of the economy. It will serve as the basis for questions from WTO members, prior to actual negotiations. To produce a high-quality report, the GOE has invested considerable time and resources across many ministries and agencies. This work has been coordinated through regular meetings of a WTO Technical Committee, and supervised by a WTO Steering Committee at the ministerial level. The Memorandum has been submitted to the Council of Ministers and the plan is to forward it to the WTO before the end of 2004. MOTI is also upgrading its WTO department to be ready for the next stage of the process. The Government, which is clearly prepared to embark on WTO accession, has used the PHRD grant for this project to prepare a Road Map for WTO accession outlining the steps to be taken for accession within the next five years.

Activities:
Activities to be funded under this component have been determined taking into account that GOE will receive support from the EU and USAID on trade capacity building. The EU aid will focus on Ethiopia's negotiations with the EU through an Economic Partnership Agreement (EPA), implementation of the COMESA regional integration agenda, and strengthening of the Quality and Standards Authority of Ethiopia. The studies and training involved will offer the potential for important synergies with the WTO

accession process, and MOTI will ensure that the programs are indeed complementary. The USAID proposal is focused on the legal and administrative dimensions of WTO accession, and as such will complement the primarily economic emphasis of the Bank's inputs. The participation of these donors will ensure that the Bank's financial contribution under this component will be sufficient to accomplish the task at hand. The Bank's participation is important to the GOE as it provides an independent source of technical assistance not associated with a party in the WTO negotiations.

The following activities will be funded under this sub-component:

(i) *Analytical Studies.* Selected studies will be conducted, notably in the services sectors, to identify the issues and options for the GOE. WTO members will be requesting further liberalization of the Ethiopian economy in various sectors. It will thus be important for the GOE to have analytical work which assesses the likely impact of such liberalization in order to identify when "concessions" may actually be in its own national interest, to support its position when they would prefer to adopt a slower pace of liberalization, to highlight where measures may be needed to assist with adjustment costs, and to be better-placed to explain the implications of WTO accession to the Ethiopian public. The negotiations are likely to be particularly difficult in the service sector (e.g., telecommunications and banking). The role of "party-affiliated" firms in all sectors (services, agriculture and manufacturing) will be an area of concern for WTO members, requiring well-informed positions on the part of the GOE.

(ii) *Short-term advisors* to help in the preparation of responses to questions from WTO members, the elaboration of negotiating positions, and the delivery of workshops.

(iii) *Training.* In addition to dissemination workshops for all studies, various seminars will be conducted for the private sector, civil society and parliament, in Addis and the provincial capitals, in order to improve public awareness of the objectives, issues and challenges involved in WTO accession.

(iv) *Materials.* A limited amount of materials and documentation will be provided to ensure that staff in MOTI and one or two other key government ministries have the material support necessary to do their jobs.

COMPONENT THREE - STRENGTHENING THE INTERNATIONAL COMPETITIVENESS OF THE PRIVATE SECTOR AND CAPACITIES OF ITS REPRESENTATIVE ORGANIZATIONS (IDA US$8 million)

Subcomponent A - BIZCAP (US$5.75 million).

Issues:
As discussed in section A and Annex 1, productivity and competitiveness of Ethiopian SMEs are among the key constraints to their growth and development, which is largely a result of low level of skills. This is due to a weak and underdeveloped BDS market. Firms are unable to produce to clients' standards and specifications. High cost of meeting the clients' technical requirements are among the primary reasons for not engaging in export/import activities. Clearly, lack of experience in the benefits of utilizing specialized BDS services, facilitating knowledge and technology transfer, severely limits the potential of firms to enter and compete in the international and regional markets.

Institutional support to PSD, provided by private and public sector, is very weak. Most of the industry-specific and professional associations are relatively new, inexperienced and unclear about their role; have low membership penetration and few services of real benefit to members, thus insufficient fee income.

Sectoral associations have not yet established good links with international networks, so as to learn from experiences elsewhere how to develop creative new income-generating services, and on how to increase membership penetration. A very similar pattern exists in professional institutes and associations. This situation negatively affects the development of the private sector as well as private sector's contribution in the policy dialog with the Government.

Activities:
Using the FIRMCAP window (IDA US$5 million), this sub-component will aim to address the skills shortages as well as the low utilization of BDS services. The improvement of the overall performance of the skills development system will be facilitated through a Matching Grant Scheme (MGS), where an individual firm will provide an agreed proportion of the costs of training and/or technical assistance it desires. Based on the analytical work and discussions with the Government and the private sector, it has been agreed that FIRMCAP will provide gradually reduced grant support for each beneficiary from 75 percent (up to an aggregate amount of US$50,000), to 50 percent (up to an aggregate amount of US$ 50,000), and 25 percent. The maximum cumulative grant per firm or group of firms under common ownership or control is US$150,000. A private firm that employs not more than 250 people in total and is involved in any form of manufacturing or any form of exporting or providing financial or non-financial services directly supportive of the value chain for these activities,[31] will be eligible to participate in FIRMCAP. Private firms that export more than 50% of their total sales value will also be eligible, irrespective of the number employed by them.

Activities will only be supported if they are part of a proper business development plan. Within each activity, only the costs of external services and travel are covered. All grants are paid on a reimbursement basis, experience shows that this is the only way of ensuring that funds are indeed spent on the activities intended. The total size of the FIRMCAP grant fund was determined based on the PHRD-funded analytical work undertaken for the Government as part of project preparation. In addition, taking into account the rapid recent takeoff in cut-flower exports, an allowance has been made for possible further expansion of the horticulture as well as other export-oriented sectors.

Using the ASCAP window (IDA US$750,000), this sub-component will also strengthen the capacities of the PSD supporting institutions (i.e., any legally registered business or professional association or chamber). ASCAP will aim at encouraging the use of outside expertise and of travel, to build capacity within associations and chambers. As with FIRMCAP, the support is based on a credible business development plan for the organization. No organization can receive more in grant funding in any year than its total revenues for the previous year. The first grant is at 100 percent; then 90 percent; then 80 percent and so on up to 50 percent. For most organizations, the initial 100 percent grant is expected to be used to create the business development plan.

Within this window, there will be special treatment of two current initiatives of wider importance for PSD: first, an initiative toward self-regulation of the professions; and second, an initiative towards proper regulation of auditing and accounting.

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[31] Private firms involved in the tourism industry are also eligible. Institutions providing financial services supportive of export competitiveness, are included irrespective of the number employed by them. Financial services may include designing of new products such as factoring, leasing, trade financing; improvements in clearance of checks; capacity building in the areas of project appraisal, credit risk assessment, etc.

Subcomponent B – SCHOOLCAP *(US$1,600,000).*

Issues:
A program focusing on institutional capacity building of a graduate business education would focus on the Faculty of Business and Economics (FBE) at Addis Ababa University (AAU). AAU has 90 percent of the country's capacity to provide post-graduate education. Any strategy for generating the academic staff necessary to support increasing undergraduate enrollments will therefore depend on the AAU's capacity to produce larger number of well qualified graduate degree-holders.[32] Institutional capacity building at the FBE is critical for at least three reasons.

(i) First, as the quantity of business education at the first degree level is improving, a program to insure that quality is also improved is essential. In the last five years, Ethiopia has increased the number of universities from 2 to 8, and the students served in those institutions from 6,000 to 30,000. In the same time five new faculties of business were created (which do not award graduate degrees) in addition to the Faculty of Business and Economics at Addis Ababa University. Most of the teachers at these five new faculties as well as the numerous business collages are trained at the FBE. More than 75 percent of the students at FBE are teachers or civil servants. Improving the quality of education at the FBE, should raise the quality of management education in Ethiopia. It should be noted that a full 33 percent of tertiary enrollments in Ethiopia are in Business and Economics.[33]

(ii) Second, as Ethiopia continues to transition, increasing the ability of civil servants to facilitate, interact with and understand the private sector - is essential. This is why civil servants account for almost half of the student body in the business programs at the FBE. Upon completion of the program, they return to ministries where they have a direct impact on the development of the private sector. Aside from providing training, the FBE program allows them to build networks which serve both the government and the private sector.

(iii) Third, even before the changes mentioned above, there were valid concerns that the FBE was both underfunded and understaffed at the graduate level. Additional strain from the combination of government mandate and rapid transition of the economy is stretching the institution well beyond its limits. An example of this is the urgent need of courses in both Trade and Competition Policy.

Further, as the Government begins the process of WTO accession and enters into EPA negotiations with the EU, it has recognized the need for a long-term program of capacity-building to provide an on-going supply of trade professionals. There is a similar need in the new field of competition policy. No graduate courses currently exist in either field at Addis Ababa University due to the limited focus on trade policy in Ethiopia, and the absence of a competition policy until now. The Ministry of Trade and Industry has requested the World Bank to enter into a partnership with the FBE to design and deliver graduate level courses in trade and competition policy.

At present, there are no faculty members currently specialized in either trade or competition policy. Thus, it will be important to draw on international expertise in the design and delivery of these courses while ensuring that there is a transfer of knowledge and a gradual increase in local training capacity. This is perfect example of how the GBSN can efficiently give the FBE access numerous experts in leading global institutions

[32] Higher education development for Ethiopia: pursuing the vision. WBG Working Paper # 29096, 2004/04/01, p.58.
[33] Ibid, p.55

Activities:
For all of the activities described below, it is important to maximize the impact of the available resources. In this spirit, video conferences and mentoring via internet will be used as often as possible. Further, experts will be coming to Ethiopia to train the staff of the FBE rather than sending Ethiopians out of country. In the case of the new policy courses, two partnerships should help ensure a cost-effective and relevant course. The existence of a GDLN center at the Civil Service College will allow for regular videoconferences with the principal foreign professor, as well as invited lecturers from the World Bank, WTO, UNCTAD, ITC, etc. The World Bank will be available to advise on the preparation and implementation of the training and to facilitate access to appropriate World Bank expertise as required. While the services of the GDLN center will have to be funded, those of the World Bank will not.

In order to design and deliver the courses, internationally-recognized professors with experience in Africa would be hired to work with two local coordinators from the FBE at UAA. The former would be expected to design a customized course relevant to Ethiopia's needs, incorporating a range of visiting lecturers with specialized expertise and perspectives, while collaborating with local professionals to build up local training capacity and prepare for the eventual transfer of the program to UAA responsibility. The complete transfer of responsibility for the trade course will probably happen only after further support from the EU.

Many students would be enrolled in the MA Economics or MBA programs, but they would be supplemented by others registering only for this course (the number and fee to be determined). Members of the WTO technical committee would be given priority in the first year of the trade course. GDLN videoconferences may be opened up to a number of observers depending on space availability. The three areas of SCHOOLCAP activity are:

<u>Curriculum Upgrade and supporting resources</u>

The students of the FBE are being taught from out of date material using methods that do not reflect global best practice in education. This activity will update the content material they are learning to help them face the challenges of the private sector in Ethiopia as well as making the program more flexible. As soon as this takes place, the students will be receiving better more current knowledge in a more effective manner.

(i) Program Syllabus Upgrade: (i) *Academic Curriculum Evaluation – Modernizing the supply*: Leading experts in each of the masters programs at the FBE will come in, evaluate and redesign the existing curriculum. New courses and an entrepreneurship center will also be designed to strengthen and modernize the FBE academic offering. (ii) *FBE Client Evaluation – Understanding the Demand*: The FBE will organize and host a workshop to understand the demand side of the management education. Then the FBE will convene a group of private sector advisors and organize a quarterly workshop for the private sector to maintain an ongoing dialogue.

(ii) Resource Upgrade to effectively deliver new Syllabus: (i) *Staff Training*: The faculty and staff of the FBE will trained in subject matter, teaching methods, case-writing, research methods, institutional administration and other relevant identified as critical for delivery of the new curriculum. (ii) *Teaching Materials*: After an evaluation of the academic resources required, the FBE will procure the materials required to deliver the new curriculum.

<u>National Transfer of Skills to other institutions</u>

(i) *Annual Training for all business educators:* To ensure that students throughout the country receive the same benefits as those in Addis, the FBE will organize and host an annual management

training workshop open to institutions in Ethiopia offering business training at the degree level in order to transfer the updated knowledge and methods from SCHOOLCAP. Further it will enhance the ability of the FBE to continually transfer their skills.

(ii) *AAU Journal of Business and Economics Studies:* The FBE will edit and publish a quarterly journal for the management training and business communities of Ethiopia. The journal will address the development of Business Education in Ethiopia and the region as well as research and cases about developments in the private sector.

Design of graduate courses in Competition Policy and Trade Policy

(i) *Graduate course in competition policy.* This one-term course will cover the basic principles of competition policy and the experience in its design and implementation in developed and developing countries. A particular effort will be made to adapt it to the Ethiopian context. The course would be repeated for four years, with progressively greater responsibility being taken by local staff.

(ii) *Graduate course in trade policy.* This full-year economics course will cover basic trade theory but will focus primarily on applied trade policy concepts and experience. It will deal with the issues involved in unilateral trade policy formulation and execution, as well as regional and multilateral trade negotiations and will explore the special trade-related challenges in the agriculture, manufacturing and services sectors. After the first year, support for this course will be continued as appropriate under an EU project currently being developed.

Subcomponent C - BIZPLAN (IDA US$650,000).

Issues:
Most private businesses in Ethiopia do not have a long business relationship with their primary bank. 58 percent of the firms surveyed by the ICA had a relationship of less than 2 years with their banks, and in fact the period was generally far less for most firms. The ICA report also found that the two main sources for investment financing by Ethiopian firms were through the use of retained earning or profits (43 percent) or cash infusions from the business owner or parent company (46 percent). Similarly, 64 percent of the firms relied on internal funds or profits for working capital needs.

Private banks appear to have little appetite to lend to the private sector, especially to SMEs for prudential reasons. Both private entrepreneurs and banks agree that the chief reason so few SMEs qualify for loans are poor business practices and lack of basic skills such as, business planning, financial management, understanding and quantifying markets, accounting and bookkeeping. (According to the 2004 ICA, banks report a large number of loan applications are rejected simply because they were incomplete or unable to demonstrate the feasibility of the business).

Limited access to credit appears to be an obstacle to investing in business expansion and enhancing capacity and productivity. Thus, the BIZPLAN sub-component aims to bring private banks and SMEs together to increase the firms' access to financial services, strengthen entrepreneur capacity to borrow from banks, and promote business development services would help improving efficiency and productivity in the Ethiopian private sector.

Activities:
The key objective of the business plan competition (BIZPLAN) is to promote entrepreneurship in the Ethiopian small and medium enterprise sector. The project will hold open, transparent, and highly visible competitions for Ethiopian SMEs. The BIZPLAN methodology will be based on best practice and the

cumulative experience of the World Bank's Development Marketplace competitions, a forum where local entrepreneurs showcase and win funds for innovative solutions to their country's development challenges. Finalists of the BIZPLAN will receive technical assistance (TA) from the competition organizer and winners of the BIZPLAN will receive a financial award that would be placed as collateral in the private banks participating in the scheme, against which the bank(s) would provide leveraged lending. The TA and finance combination is designed to address the two main constraints to entrepreneurship growth.

Ethiopia BIZPLAN model. BIZPLAN will be held annually for at least two years that will require Enterprise Ethiopia through BMU to manage and execute the program. BIZPLAN will consist of the following major components along the timeline discussed.

(i) *Call for proposals.* The competition will be kicked off with an open call for proposal through an national outreach and awareness raising campaign conducted in as many local languages as possible.

(ii) *Assessment of these proposals and selection of finalists.* Once all applications are submitted, the BIZPLAN implementation team will recruit assessors from multiple institutions to evaluate these short proposals and identify finalists who will be invited to submit a fuller business plan.

(iii) *Training/TA on business plan writing for all finalists.* After selection of the finalists, the BPC implementing agency will organize an intensive training, after which the finalists will be asked to submit their full business plan.

(iv) *Organizing an "entrepreneurs' marketplace" to showcase the finalists and select winners.* All of the finalists will convene at a particular venue on a determined date for a "marketplace" or mini-trade fair that will be open to the public.

(v) *Disbursing awards to the winners.* Following the competition, the BIZPLAN team will orient the finalists, ensure that the awards are provided to the winners. The project will provide a certain amount of money to the participating banks as collateral against which, the banks will on-lend at least 2 times that amount to the winner.

(vi) *Monitoring and evaluation of the progress and performance of the winners.* The BIZPLAN implementing agency will also design and execute an appropriate monitoring and evaluation system to judge the progress and performance of the winners.

Annex 5: Project Costs

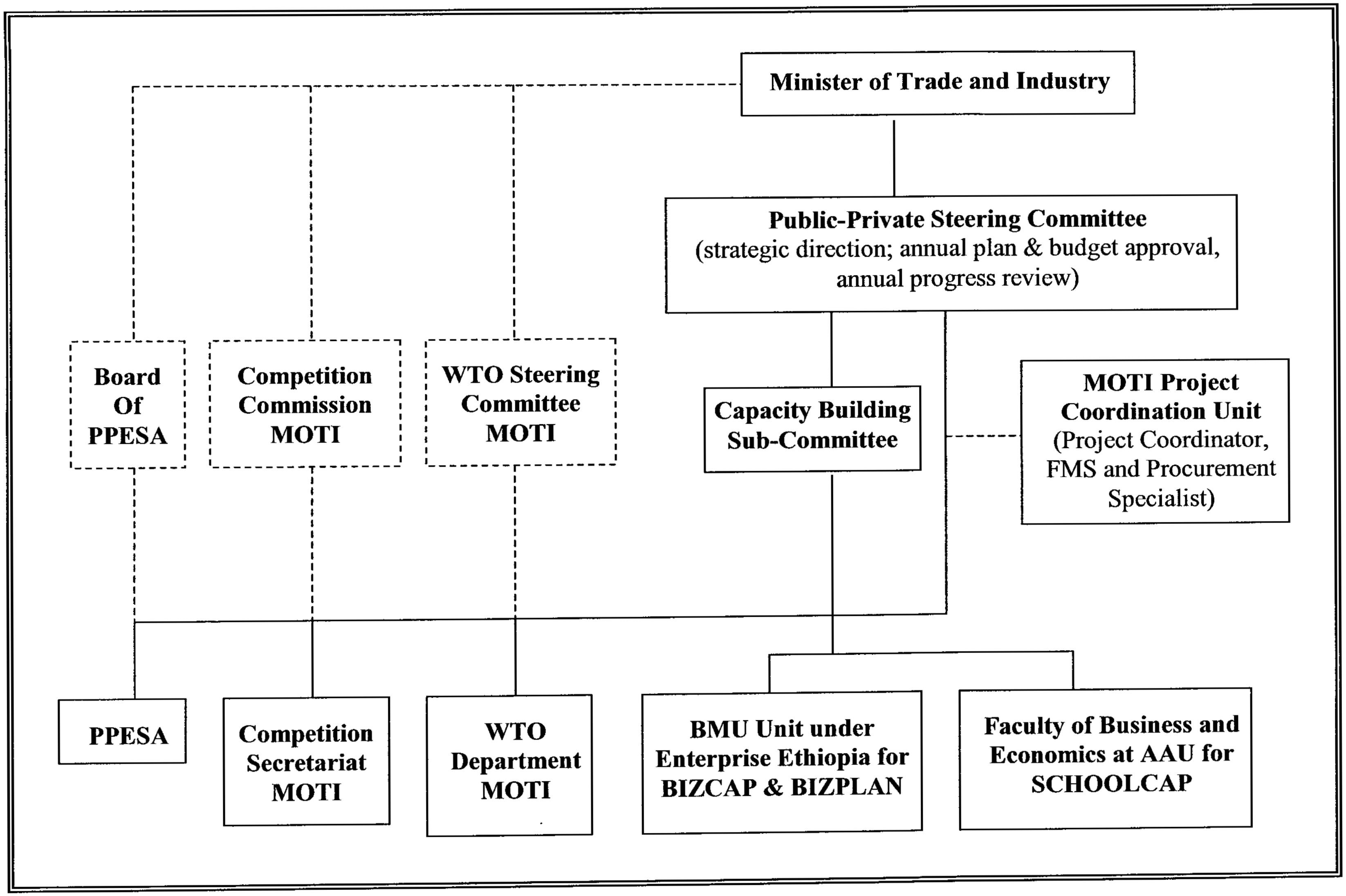
ETHIOPIA: Private Sector Development Capacity Building

Project Cost By Component and/or Activity	IDA Local US$ million	IDA Foreign US$ million	Local contribution US$ million	Total US$ million
Component One - Accelerating the Implementation of Privatization Program	1.42	8.46	7.00	16.88
Component Two - Improving the Business Environment through Implementation of Competition Policy and Accession to WTO	0.05	1.05	-	1.10
Component Three - Strengthening the International Competitiveness of the Private Sector and the Capacities of its Representative Organizations	0.10	7.90	8.31	16.31
Implementation				
• Project Coordination Unit (PCU)	0.09	0.14	0.60	0.83
• BMU Unit under Enterprise Ethiopia	0.09	0.68	-	0.77
Total Baseline Cost				
Physical Contingencies	0.00	0.00	-	0.00
Price Contingencies	0.22	1.27	-	1.49
Counterpart funding	-	-	2.4	2.4
Unallocated	-	2.53	-	2.52
Total Project Costs	1.97	22.03	18.31	42.31
Interest during construction	-	-	-	-
Front-end Fee	-	-	-	-
Total Financing Required	**1.97**	**22.03**	**18.31**	**42.31**

Annex 6: Implementation Arrangements

ETHIOPIA: Private Sector Development Capacity Building

Figure 5: Summary Organizational Chart for PSD CB Project Management



The oversight of the Project will be formally delegated by the Minister of Trade and Industry to a Public-Private Steering Committee (PPSC) chaired by the Minister of Trade and Industry. PPSC will consist of nine members with membership from the public and the private sectors. From the public sector the members will include the President of the Board of PPESA, the Chairman of the Competition Commission, the Chairman of the WTO Steering Committee two Ministers of State representing MOTI and the President of Addis Ababa University. The private sector members will comprise individuals nominated by agreement of the Chamber of Commerce, Industry and Professional Associations (e.g., Bankers Association).[34] These individuals are expected to be persons of standing and integrity, who have the confidence of the private sector. They will serve on the Committee in their individual capacity, not as formal representatives of particular organizations. The process of establishing the Committee will be the responsibility of the PCU. PPCS will meet at least once a year and its responsibilities will include:

(i) Provide strategic guidance and oversight for the project;
(ii) Approve annual work program and budget;
(iii) Review quarterly progress reports and address any major problems affecting project implementation;
(iv) Review reports including the audit, mid-term review and the implementation completion report.

The Steering Committee will be assisted by a small Project Coordination Unit (PCU) funded jointly by the project the Government, and located within MOTI. It has been agreed that the Government will fund the procurement and financial management (FMS) specialists, and office costs (including office space, communications and equipment), while the PSD CB project will fund the Project Coordinator and necessary training, establishment and operation of an M&E system, and the costs of semi-annual audit of accounts. For the purpose of effective implementation and speedy disbursement, the PCU will be dedicated exclusively to the management of the PSD CB Project. Based on the recommendations of the procurement and FMS capacity assessment of MOTI conducted during the appraisal mission it has been agreed that PCU will be staffed with dedicated full-time personnel, assigned or employed for the period of the Project. The PCU will comprise of a minimum of three staff, including a Project Coordinator (to be funded by the project), a procurement specialist and a financial management systems specialist (to be funded by the Government). The PCU would be responsible for handling procurement and FMS functions (including the project account) and the other administrative requirements of the project. The Project Coordinator will also be responsible for coordination with other donors and relevant programs/projects. A qualified project coordinator, who was competitively selected, has effectively managed project preparation activities under the PHRD grant. The Government indicated that it will extend Coordinator's appointment. The procurement and financial management specialists will be assigned from MOTI if there are adequately qualified candidates, or employed on the contract basis. Establishment of a PCU with key qualified personnel is a condition of project effectiveness, while establishment of the Project Steering Committee is to take place within six months of project effectiveness.

Project management and implementation for all components will be mainstreamed/delegated to the following agencies: (i) PPESA for Component One, (ii) Competition Secretariat for Subcomponent A, and the WTO Department in MOTI for Subcomponent B under Component Two; (iii) Enterprise Ethiopia for BIZCAP and BIZPLAN, [35] through the BMU staffed with a competitively selected matching grant manager (assisted by a Matching Grant international expert advisor) and a BIZPLAN officer; and (iv) Faculty of Business and Economics, AAU for SCHOOLCAP. These agencies will be responsible for day-to-day management of the respective components, annual work plan and budget programming, project accounting, monitoring, public relations and reporting. They will manage all technical aspects of the

[34] Staff employed by Chambers or Associations are not eligible due to potential conflict of interest as they are potential beneficiaries of ASCAP.
[35] EE will operate in accordance with the operational guidelines set out in POM.

project (with assistance from the long term advisors where applicable). In this context, they will prepare terms of reference, short lists of consultants and advisors, and manage the supervision of consultants. They will be responsible for preparing all reports required under the project for their respective project components. In addition to overseeing the implementation of the programs, they will also ensure the necessary cooperation across government. The private sector and civil society will participate in the process through their membership in the Steering Committee and through specialized consultations and workshops.

Further, for Component Four, a dedicated sub-committee will be established under the Project Public-Private Steering Committee. This sub-committee will be known as the Capacity Building Sub-Committee (CB Sub-Committee). It will be chaired by the State Minister for Industry, with the following members: Project Coordinator and three private sector members selected by the PPSC from among their members. The CB Sub-Committee will be responsible for the oversight of all three sub-components of Component Three. In particular, the CB Sub-Committee will oversee the operations of:

(i) Enterprise Ethiopia for BIZCAP and BIZPLAN, through the BMU staffed with a competitively selected matching grant manager and a BIZPLAN officer. MGS manager will be assisted by a Matching Grant international expert advisor, who will, on bi-annual basis, review procedures and implementation of the scheme, and recommend changes to the CB Sub-Committee in a report that will also be made available to IDA. EE will operate in accordance with the operational guidelines set out in POM.

(ii) Faculty of Business and Economics at AAU, which is charged with the implementation of SCHOOLCAP.

The BMU Manager will report to the director of EE, who will then report directly to the CB Sub-Committee. The Dean of FBE will similarly report directly to the CB Sub-Committee. They will report on the basis of annual operational plans, and quarterly progress reports. Any changes in legal status of EE would require prior IDA No-Objection. BIZCAP will be governed by a legally-binding Operations Manual, which will be referenced in the Development Finance Agreement between the Government and IDA.

Annex 7: Financial Management and Disbursement Arrangements

ETHIOPIA: Private Sector Development Capacity Building

Introduction

The Bank's policy (OP 10.02) requires borrowers and project implementing agencies to maintain financial management systems, including accounting, financial reporting and auditing systems, adequate to ensure that they can provide to the Bank accurate and timely information regarding project resources and expenditures. The assessment of the financial management systems of this project is done inline with the guidelines issued by the Financial Management Sector Board in June 2001, and revised on October 1, 2003.

Country Issues

The Country Financial Accountability Assessment (CFAA) carried out jointly by the government, Bank and donors indicated that although considerable progress has been made in the budgeting process, more needs to be done in the areas of budgeting, accounting, reporting and auditing and the CFAA report highlighted development action plan that should be implemented in order to improve the public financial management systems. Most of the action plan will be covered in the existing financial reforms under way through the financial supports of donors. Various capacity building efforts are being undertaken at the regional levels as well. Despite some progresses made in last three years, there are weaknesses in medium term planning, accounting, auditing and reporting. Remedial actions on the weaknesses will be taken through the Expenditure Management and Control Program (EMCP), the Capacity Building Project for Decentralized Service Project (CBDSD) and Public Service Delivery Capacity Building Program (PSCAP).

Risk Analysis

Summary Risk Assessment

Project: PSD CB

Date: 19 November 2004

	Risk Assessment				
	H	**S**	**M**	**N**	**Risk Mitigating Measures**
Inherent Risk					
Lack of trained manpower in the area of accounting and auditing and low pay scales for civil servants		√			There is a civil services reform Program in progress undertaken by the government in developing the accounting and auditing profession and improve the salary scale of civil servants. This will have a long-term effect rather than a short-term effect.
There is no national professional association and accounting and auditing standards			√		This area is covered under the civil services reform Program
The project organizational structure is new and the financial management systems to be in place is not tested			√		The development of good project organizational structure and financial management systems will be an effectiveness conditions
Overall Inherent Risk		√			
Control Risk					
1. Implementing Entities The project organizational structure has not yet been finalized and not			√		Developing clear cut responsibilities for the PCU and staff it with adequate manpower

	Risk Assessment				
	H	S	M	N	Risk Mitigating Measures
staffed					
2. Funds Flow					
3. Staffing Lack of trained manpower and low salary scale		√			The salary scale will be attractive to obtain qualified people
4. Accounting Policies and Procedures The financial management manual has not yet been finalized			√		The accounting policies and procedures to be designed will be concise and clear to accommodate the needs of the project
5. Internal Audit There will not be an internal audit section for the project			√		As there will not an internal audit department for the project, the internal control systems of the project will be strengthened at all levels.
6. External Audit Low capacity in the auditing profession		√			Developing the TOR of the audit and appointment of auditors immediately after effectiveness
7. Reporting and Monitoring Non-regular reporting from lower levels, which are not complete and relevant			√		Developing a good reporting and monitoring mechanism
Overall Control Risk			√		

H – High S – Substantial M – Moderate N – Negligible or Low

Implementing entities

The oversight of the project will be formally delegated by the Minister of Trade and Industry to a Public-Private Steering Committee (PPSC) chaired by the Minister of Trade and Industry. PPSC will consist of nine members with membership from the public and the private sectors as detailed in Annex 6.

The Steering Committee will be assisted by a small Project Coordination Unit (PCU) funded jointly by the project the Government, and located within MOTI. It has been agreed that the Government will fund the procurement and financial management (FMS) specialists, and office costs (including office space, communications and equipment), while the PSD CB project will fund the Project Coordinator and necessary training, establishment and operation of an M&E system, and annual audit costs of accounts. For the purpose of effective implementation and speedy disbursement, the PCU will be a unit dedicated exclusively to the management of the PSD CB Project, staffed with dedicated full-time personnel, assigned or employed for the period of the Project. The PCU will comprise of a minimum of three staff, including a Project Coordinator (to be funded by the project), a procurement specialist and a financial management systems specialist (to be funded by the Government). The PCU will oversee the procurement and disbursement processes (including the project account) and the other administrative requirements of the project. The PCU will be responsible for the overall financial management of all the resources of the Project, the preparation of regular financial monitoring reports and submit the same to IDA, and preparation of the annual financial statements of the Project and submit the draft accounts to external auditors for annual audit. The Project Coordinator will also be responsible for coordination with other donors and relevant programs/projects.

The Management of Component One will be delegated to PPESA. The Management of Component Two will be delegated to the Competition Secretariat on activities related to the competition policy and to WTO Secretariat on activities related to WTO accession. FBE at AAU will be responsible for implementing SCHOOLCAP. Enterprise Ethiopia, through a BMU will be responsible for implementing BIZCAP and BIZPLAN. A BMU will be staffed with competitively selected matching grant manager charged with running the BIZCAP scheme and a BIZPLAN officer charged with running the BIZPLAN. The MGS manager will be assisted by a Matching Grant international expert advisor.

The matching grant manager will report to through a director of EE and FBE dean will report directly to the CB Steering Committee, established to oversee all the subcomponents of Component Three, on the basis of annual operational plans, and quarterly progress reports. An international MGS advisor, on bi-annual basis, will review procedures, implementation of the scheme and recommend changes to the CB Sub-Committee in a report that will also be made available to IDA. EE will operate in accordance with the operational guidelines set out in POM. Any changes in legal status of EE would require prior IDA No-Objection. BIZCAP will be governed by a legally-binding Operations Manual, which will be referenced to in the Development Financing Agreement between the Government and IDA

MoTI has Finance Division under the Finance and Administrative Department. The Finance Section has Budget and Accounts sections under it. The staff under the Finance Division do not have the required qualifications and experience to handle the accounting and reporting requirements of project. As a result of this, it has been agreed with the borrower to employee additional staff under the PCU to handle the financial transactions of the project.

Strengths and Weaknesses

The country's discipline in executing budget and compliance with the existing government regulations is the major strength in implementing this project. The PCU will have full time finance office and an assistant with adequate educational qualifications and experience. The project will be implemented centrally and this is an advantage in producing the required information on time. The major weakness is the PCU has not yet been established and fully staffed. Finding suitable candidates will be a challenging task considering the labor market in the country

Flow of funds

The Government of Ethiopia, and the World Bank will provide financial support to the project. Two Special Accounts will be opened at the National Bank of Ethiopia to receive funds from IDA for project implementation, one for the credit and the other for the grant. Details on the use and management of the SAs are discussed in the disbursement section. The PCU will be responsible for monitoring the status of disbursements from the Special Accounts and to process applications for replenishment in a timely manner so as to ensure an unobstructed flow of funds to the project and its beneficiary components.

One local currency account in Birr will be opened at a commercial bank acceptable to IDA to transfer money from the USD SA to cover four months expected expenditures. Another local currency may be opened to be used for the counterpart contribution. The SA and the two local currency accounts will be managed by the PCU.

Transfer of money to the private sector and its representative organizations will be made in accordance with grant agreements to be entered into between the relevant CB Subcommittee and the beneficiaries. No disbursements will be made to beneficiaries unless the required grant agreements are signed. Detailed procedures on recording, reporting and auditing arrangements will be included in the POM and FM manual.

Staffing

The PCU should be staffed with adequate and trained people, who are capable of handling and managing the project financial resources. The staffing of the PCU will be effectiveness conditions.

Accounting policies and procedures

The PCU will use accrual system of accounting on a double entry basis except fixed assets and stocks for which the cost of fixed assets and stocks will be recognized as expenditure at the time of purchases. As far as possible the PCU will use the Public Sector International Accounting Standards in recording and reporting the financial transactions of the project. Detailed procedural guidelines are included in the financial management manual of the project.

Internal Controls

Internal control comprises the entire systems of control, financial or otherwise, established by management in order to (a) carry out the project activities in an orderly and efficient manner; (b) ensure adherence to policies and procedures; and (c) safeguard the assets of the project and secure as far as possible the completeness and accuracy of the financial and other records.

The project is expected to design and install internal control systems, which will help the management of the project in achieving the project objectives in orderly and efficient manner. Since the project will not have an internal audit section, the control systems to be designed should compensate for the non-existence of the internal audit. Thus, the main focus of the internal control is placed on the following:

- *(i)* Segregation of duties
- *(ii)* Physical control of assets
- *(iii)* Authorization and approval
- *(iv)* Clear channels of command
- *(v)* Arithmetic and accounting accuracy
- *(vi)* Integrity and performance of staff at all levels
- *(vii)* Supervision

External Audit

The annual project financial statements of the project, including the movement in the special accounts (SA) and Statements of Expenditures (SOEs) will be audited by an external auditor acceptable to IDA. The annual audited financial statements, along with the management letter, will be submitted to IDA not later than six months after the end of the fiscal year.

Since the Federal Auditor General is responsible for auditing all government funds, it will conduct the audit or assign other external auditor to the project. The terms of reference for the external auditors will be developed immediately after effectiveness.

According to the new audit policy of IDA, PCU will prepare a project accounts, which include all the sources from donors and the government and related project expenditure and the auditors will express a single opinion on the consolidate project accounts. The TOR for the external audit will be agreed immediately after effectiveness.. The audit reports should be submitted to IDA six months after the end of each fiscal year, which ends on 7 July of each year.

Reporting and monitoring

The PCU will establish adequate accounting and reporting systems, which will produce accurate and reliable information regarding project resources and expenditures. The systems should provide reliable records and reports on all assets and liabilities and financial transactions of the project, and sufficient financial information for managing and monitoring activities. The accounting and reporting systems will, among other things, include the:

- *(i)* Flow of funds
- *(ii)* Accounting policies to be followed

(iii) Accounting systems
(iv) Chart of accounts
(v) Reporting mechanism
(vi) Budgeting process
(vii) Auditing arrangements
(viii) Staffing requirements

The final financial management manual should be issued before the effectiveness of the project.

The PCU will produce quarterly Financial Monitoring Reports (FMRs) and submit the same to IDA 45 days after the end of each quarter. The FMRs will include financial, physical progress and procurement information. At a minimum, the financial reports must include the sources and uses of funds, expenditures by main expenditure classifications, beginning and ending cash balances and other supporting schedules. The formats of the FMRs will be agreed during negotiation.

Action Plan

	Action to be taken	Expected completion date	Responsible body
1	Preparation of a financial management manual describing the flow of funds, accounting, reporting and auditing arrangements	Before effectiveness	Borrower
2	Appointment of a financial officer at the PCU	Before effectiveness	Borrower
3	Opening of bank accounts at the national level	Before effectiveness	Borrower

Conditions
The establishment of satisfactory financial management systems, including a financial management manual, would be one of the conditions of effectiveness. The appointment of a finance officer at the PCU would also be a condition for effectiveness. The opening of local currency account to depositing the counterpart contribution of Birr 500,000 to the account would be another effectiveness condition.

Financial Covenants
The borrower shall maintain a financial management system and prepare project financial statements in accordance with International Accounting Standards. The borrower, PCU, shall submit audited project financial statements to IDA no later than six months after the close of each fiscal year. The fiscal year ends on 7 July of each year. The audited financial statement will include all sources of funds for the project, including other donors and the government. The borrower will also submit additional financial reports as required by the Bank. The PCU will submit quarterly FMRs to IDA forty-five days after the end of each calendar year.

Supervision Plan
Considering the nature of the project, the Bank's supervision mission should be as regular as possible. The mission's objectives will include ensuring that strong financial management systems are maintained for the project throughout its life. A review will be carried out regularly to ensure that expenditures incurred by the project remain eligible for IDA funding. The Project Status Report (PSR) will include a financial management rating for the component. Each year, there should be at least two main supervision missions and another two interim supervision missions by the country office staff and PCU. These should explain the FMS supervision needs based on the risk analysis. There would be two missions by the FMS in the first year and one a year subsequently.

Disbursement Arrangements

The closing date of the proposed project will be June 30, 2011. The proposed IDA operation would be disbursed against the categories shown in below. Disbursements will be made in accordance with procedures and policies outlined in the Bank's *Disbursement Handbook*.

Allocation of project proceeds

Expenditure Category	Amount in US$ million	IDA credit	IDA grant	Financing percentage
Goods	0.48	0.48	-	100% of foreign expenditures and 90% of local expenditures
Consultants' Services and audits	4.92	4.92	-	100% of foreign expenditures and 85% of local expenditures
Severance Payments	7.14	2.14	5.00	100%
Matching Grants*	7.10	7.10	-	100% of the amounts disbursed
Training and Workshops	1.33	1.33	-	100%
Operating costs	0.50	0.50	-	90%
Unallocated	2.53	2.53	-	
Total	24.00	19.00	5.00	

NOTE: figures include contingencies.
*) Matching Grant category includes funding for FIRMCAP (US$5.57mil); ASCAP (US$0.84mil); and BIZPLAN (US$0.69mil).

There are two ways to disburse funds from the Bank. The first one is the traditional disbursement method, which uses SA, SOE procedures and direct payment procedures. The second one is the report-based method, in which regular Financial Monitoring Reports (FMR) plus additional statements will be the basis for disbursement.

Since the PCU has not been established, it was not possible to assess its capacity in producing regular financial and other reports so as to use the report-based disbursement method from the start of the project. It is agreed with the Government that disbursement from IDA will follow a traditional disbursement method at the start of the project. If the borrower is interested in using the second method, it is possible to switch to a report-method of disbursement after the Bank has made a full assessment.

Uses of Statement of Expenditures (SOEs)

Disbursements made on the basis of SOEs will be as follows(a) goods costing less than US$150,000 equivalent per contract; (b) severance payments; (c) services of individual consultants costing less than US$50,000 equivalent per contract; (d) services of consulting firms under contracts costing less than US$100,000 equivalent per contract, (e) Grants costing less than US$25,000 per AC Grant Agreement, US$15,000 per BP Grant Agreement and US$150,000 per AC Grant Agreement, (f) training and, (g) operating costs, all under such terms and conditions as the Association shall specify by notice to the Borrower.

The borrower will retain all the supporting documentation for SOEs, including completion reports and certificates. The supporting documents will be made available to IDA during project supervision and will be audited annually by independent auditors acceptable to the Association. Disbursements for expenditures above these thresholds will be made against presentation of full documentation relating to those expenditures. During the project launch workshop, there will be a session on proper preparation of withdrawal applications, including the preparation and submission of required supporting documents.

Special Account

To facilitate disbursements against eligible expenditures under the Project, the PCU will establish two Special Accounts (SAs) in the National Bank of Ethiopia. SA-A will be opened for the Credit and SA-B will be opened for the Grant. The authorized allocation for the SA-A and SA-B will be US$2.5 million and US$0.5 million respectively. Upon effectiveness, IDA will deposit an initial deposit up to US$1.5 million into SA-A and US$0.25 million into SA-B. Once the total disbursements from the Credit and Grant accounts, including commitments, have reached an aggregate amount of SDR 5 million and SDR 1million respectively, the initial allocations may be increased up to the authorized allocations. The PCU will submit replenishment applications at least once a month. The Special Accounts will be audited annually by independent auditors acceptable to IDA along with the project financial statements.

Counterpart fund

The Government of Ethiopia will open a local currency account in a commercial bank acceptable to IDA and will deposit Birr 500,000 for the first project year and subsequent deposits at the beginning of each project year based on the annual budget of the project. The overall counterpart contribution represents about 10 percent of the estimated project cost of the Project.

Annex 8: Procurement Arrangements
ETHIOPIA: Private Sector Development Capacity Building

A. INTRODUCTION

Procurement for the proposed project would be carried out in accordance with the World Bank's "Guidelines: Procurement Under IBRD Loans and IDA Credits" dated May 2004; and "Guidelines: Selection and Employment of Consultants by World Bank Borrowers" dated May 2004, and the provisions stipulated in the Legal Agreement. The various items under different expenditure categories are described in general below. For each contract to be financed by the Project, the different procurement methods or consultant selection methods, the need for pre-qualification, estimated costs, prior review requirements, and time frame are agreed between the Borrower and the Bank in the Procurement Plan. The Procurement Plan will be updated at least annually or as required to reflect the actual project implementation needs and improvements in institutional capacity.

The Government, as part of the procurement reform process, has prepared a new procurement code and has started developing new standard bidding documents for the procurement of goods, works and services. The National Bidding documents that are being prepared can be used for National Competitive Bidding after verification by the Bank that the country's laws and procedures also satisfy Bank requirements.

Procurement of Goods: Goods procured under this project would include: Office Equipment, books, Journals, computer and Software and office supplies. The procurement will be done using the Bank's SBD for all ICB and National SBD agreed with or satisfactory to the Bank.

Selection of Consultants: Consultants services shall include (i) transaction advisors, (ii) design of monitoring and evaluation system and contract management system, and (iii) environmental impact assessment. Short lists of consultants for services estimated to cost less than $ 200,000 equivalent per contract may be composed entirely of national consultants in accordance with the provisions of paragraph 2.7 of the Consultant Guidelines. Consultant services will be selected using Banks SRFPs. The selection will be conducted following QCBS, QBS, LCS, IC and other procurement methods in accordance with the procurement plans.

Training: Training to be provided shall include training of PPESA staff and board members on specific topics such as negotiation skills and contract management. In addition staff training workshops and seminars shall be conducted.

Others: Other costs to be covered by the program shall include co-financing of payments of severance package and additional funding for safety net programs for redundant workers. In addition the program shall finance agreed portions of the costs of training and technical assistance to private firms.

The procurement procedures and SBDs to be used for each procurement method, as well as model contracts for works and goods procured, will be presented in the POM.

B. ASSESSMENT OF THE AGENCY'S CAPACITY TO IMPLEMENT PROCUREMENT

Procurement Capacity

The Country Procurement Assessment Report (CPAR) done in 1998 and 2002 has identified procurement capacity as one of the major weaknesses in public sector procurement. The capacity assessments for the project also confirm these findings.

Procurement Capacity Assessment of the lead Agency the Ministry of Trade and Industry was done. Within the Ministry, the Property Administration Section is responsible for the preparation of tender documents for procurement of goods. The section is under the Property Administration and General Service Division, which reports to the Administration and Finance Services Department. The Section is staffed with two purchasers in addition to the section head. Selection, employment and management of consultant services is done by Ad-hoc committees formed on a case by case basis. Evaluation of tenders is done by a tendering committee composed of members from IT specialist, finance, Property Administration and General Service Division.

The key weaknesses identified in the procurement management for implementation of the project include (i) Number and qualification of procurement staff is not adequate, (ii) Adequate procurement training has not been given to staff involved in the procurement decision making process, (iii) There is very limited experience especially in selection of consultants and International procurement; (iv) Evaluation of tender and preparation of evaluation reports is done by a tendering committee working on procurement on a part time basis, (v) No standard and acceptable bidding documents available and the quality of the current bidding documents is not satisfactory, and (vi) Records management systems are not adequately organized;

It was agreed that the following actions would be carried out to enhance the procurement capacity of the Ministry for the project.

(i) One national procurement specialist with adequate qualification and experience would be employed/assigned at the Ministry of Trade and Industry on a full time basis with primary responsibility being management of procurement activities under the project. The TOR would be agreed by negotiation and the employment/assignment of the specialist would be completed before effectiveness. The procurement specialist should, as a minimum, have a first degree and three years experience in procurement involving selection of consultants and goods procurement. The responsibilities of the consultant would include, preparing and monitoring procurement plans, bidding documents, bid evaluation reports, and contract documents. The procurement staff would report to the PCU. A support staff would be assigned to assist the procurement staff in routine procurement processing activities. The procurement specialist would be provided with full time access to a personal computer with printer.

(ii) The tendering committee would be re-organized so that qualified end users participate in the evaluation of tenders as required as member of the tendering committee. The Procurement staff to be assigned for the project would be a permanent member of the committee.

(iii) If a procurement person with adequate qualification is not found the best qualified person would be selected and made to participate on a comprehensive and intensive Procurement Training Program at one of the regional (ESAMI or GIMPA) or other similar training programs as soon as possible. In addition one or more staff from each of the offices that manage the various projects components would participate in an intensive procurement training program.

(iv) A comprehensive procurement training program would be organized for staff that would be involved in the procurement decision making process including key staff from each of the offices that manage the components, including PPESA, Competition Secretariat and WTO Department shall be conducted prior to the Effectiveness of the project (if funds are available) or within two month after effectiveness.

In addition an orientation workshop would be conducted to staff that would have a role in procurement process but could not participate in the comprehensive training program within two months of effectiveness.

Procurement Implementation Arrangement

The Project Coordination Unit (PCU) within the Ministry of Trade and Industry would be responsible for handling procurement functions for the project. As noted above in order to build the necessary capacity within the PCU a qualified Procurement specialist would be assigned or employed on a full time basis. A tendering committee composed of some members of the current MOTI tendering committee and the PCU procurement specialist would be responsible for evaluation of bids both for selection of consultants and goods procurement. End users of the procured services or goods would participate as members of the tendering committee as required to ensure that the procurement is done according to their needs.

To further enhance the capacity of the Ministry procurement of goods may be outsourced following a competitive process to Private or public Enterprise (financially and administratively autonomous) within the country.

Final decisions on procurement will be made by the respective heads of the various components. The detailed procedure to be followed is outlined in the Project Operational Manual. The offices managing the various components of the projects may be delegated to handle their own procurement if they demonstrate that they have the capacity.

The overall project risk for procurement is high.

C. PROCUREMENT PLAN

The Borrower, at appraisal, developed a procurement plan for project implementation which provides the basis for the procurement methods. This plan has been agreed between the Borrower and the Project Team on November 18, 2004 and is available at PCU, MOTI. It will also be available in the project's database and in the Bank's external website. The Procurement Plan will be updated in agreement with the Project Team annually or as required to reflect the actual project implementation needs and improvements in institutional capacity.

D. FREQUENCY OF PROCUREMENT SUPERVISION

In addition to the prior review supervision to be carried out from Bank offices, the capacity assessment of the Implementing Agency has recommended biannual supervision missions to visit the field to carry out post review of procurement actions.

E. DETAILS OF THE PROCUREMENT ARRANGEMENTS INVOLVING INTERNATIONAL COMPETITION

1. Goods and Non Consulting Services

(a) List of contract packages to be procured:

1	2	3	4	5	6	7	8	9
Ref. No.	**Contract (Description)**	**Estimated Cost US$ ('000)**	**Procurement Method**	**P-Q**	**Domestic Preference (yes/no)**	**Review by Bank (Prior / Post)**	**Expected Bid-Opening Date**	**Comments**
1-G	Implementation of competition policy - Workshop Materials	30.00	Local shopping		Yes	Post	Q3 Y1 (Aug-01-05)	20K Y1, 10K Y2
2-G	WTO accession workshop materials	30.00	Local shopping		Yes	Post	Q3 Y1 (Aug-01-05)	10K Y1, 20K Y2
3-G	SCHOOLCAP Teaching materials	130.00	NCB		Yes	Prior	Q3 Y1 (Aug-01-05)	130K Y1, 13.2 Y2
4-G	BMU under EE							
4-G1	1. Office furniture for BMU	5.00	Local shopping		Yes	Post	Q1 Y1 (Jan-05-05)	5K Y1
4-G2	2. Office equipment for BMU	18.00	Local shopping		Yes	Post	Q1 Y1 (Jan-05-05)	17.8K Y1

Total cost of goods: **US$213,000**

2. Consulting Services

(a) List of consulting assignments.

1	2	3	4	5	6	7
Ref. No.	**Description of Assignment**	**Estimated Cost US$ ('000)**	**Selection Method**	**Review by Bank (Prior / Post)**	**Expected Proposals Submission Date**	**Comments**
Firms						
1-FSC	System integration & enhancement	150.00	QCBS	Prior	Q2 Year 1 (Apr-01-05)	50K Y1, 100K Y2
2-FSC	Team of transaction advisors to assist PPESA	600.00	QCBS	Prior	Q2 Year 1 (Apr-01-05)	300K a year
3-FSC	Full and partial environmental assessment	400.00	QCBS	Prior	Q2 Year 1 (May-01-05)	200K a year
4.FSC	WTO analytical studies for policy option	300.00	QCBS	Prior	Q2 Year 1 (June-01-05)	100K Y1, 200K Y2
5-FSC	MBA syllabus upgrade	157.60	QCBS	Prior	Q2 Year 1 (May-01-05)	82.7K Y1, 74.9K Y2
6-FSC	Curriculum evaluation	107.0	QCBS	Prior	Q4 Year 1 (Oct-01-05)	101.3K Y1, 6.4K Y2

1	2	3	4	5	6	7
Ref. No.	**Description of Assignment**	**Estimated Cost US$ ('000)**	**Selection Method**	**Review by Bank (Prior / Post)**	**Expected Proposals Submission Date**	**Comments**
7-FSC	WTO competition course development	250.40	QCBS	Prior	Q2 Year 1 (Apr-01-05)	200K Y1, 50.4K Y2
8-FSC	MGS Expert advisor	194.00	QCBS	Prior	Q2 Year 1 (Apr-01-05)	121K Y1, 73K Y2
9-FSC	External audit	20.00	LCS	Prior	Q3 Year 1 (July-01-05)	10K a year
10-FSC	Preparation of implementation guidelines, procedure and methods	100.00	QCBS	Prior	Q2 Year 1 (Apr-01-05)	50K a year
Individual Consultants						
11-ISC	Design of redundancy policy	120.00	QCBS	Prior	Q1 Year 1 (Feb-01-05)	120K Y1
12-ISC	Studies: design of contract monitoring system	50.00	IC	Post	Q2 Year 1 (May-01-05)	50K Y1
13-ISC	WTO accession short term advisor	10.00	IC	Post	Q1 Year 1 (Feb-01-05)	10K Y2
14-ISC	Matching Grant manager	72.00	IC	Prior	Q2 Year 1 (Apr-01-05)	36K a year
15-ISC	Matching Grant receptionist	6.00	IC	Post	Q1 Year 1 (Feb-01-05)	3K a year
16-ISC	BIZPLAN officer	24.00	IC	Post	Q1 Year 1 (Feb-01-05)	12K a year
17-ISC	Project coordinator	30	IC	Prior	Q1 Year 1 (Jan-01-05)	15K a year
18-ISC	M&E specialist	10.00	IC	Post	Q2 Year 1 (June-01-05)	3K a year
19-ISC	Annual survey	23.00	IC	Post	Q3 Year 1 (Oct-01-05)	5K a year

Total cost of services for Firms: **US$2,279,000** and for individual consultants: **US$345,000**

(b) Consultancy services estimated to cost above US$100,000 per contract for firms, Consultant services estimated to cost US$50,000 for Individuals and all single source selection of consultants will be subject to prior review by the Bank.

(c) Short lists composed entirely of national consultants: Short lists of consultants for services estimated to cost less than US$200,000 equivalent per contract, may be composed entirely of national consultants in accordance with the provisions of paragraph 2.7 of the Consultant Guidelines.

Annex 9: Economic and Financial Analysis

ETHIOPIA: Private Sector Development Capacity Building

Cost Benefit Analysis Summary

	Present Value of Flows		Fiscal Impact	
	Economic Analysis	**Financial Analysis**	**Taxes ($ million)**	**Subsidies**
Benefits (US$ million)	45.1		5.9	N/a
Costs (US$ million)	22.5			
Net Benefits (US$ million)	22.6			
ERR (%)	27.7			

Note:

- The discount rate used for the economic analysis is 12%.
- The results above are based on a 12-year forecast timeframe.

Summary of Benefits and Costs:

Base Case Results.

The cost-benefit analysis of this project presents the usual difficulties faced in all project evaluation in developing countries with, mainly, a lack of reliable time series data require to calibrate the model and difficulty in finding the appropriate shadow prices. For this reason, proxies (based on market assessments and, when available, results from implementation completion reports of similar projects) are used when explicit prices and calibration factors are not available. The difficulty in quantifying the economic benefits results mainly from the lagged effects of the project, from the indirect relationship between the support provided and the development impact, and the difficulty to factor in inter-firm linkages and intersectoral dependencies.

That said, a simple model has been built to calculate the decision variables: the Net Present Value (NPV) and the Economic Rate of Return (ERR). The sensitivities of these variables to key assumptions used are diagnosed under different scenarios to evaluate the robustness of the project. A counterfactual case ("without project") was used to derive the net effect by isolating performance not explained by the project.

The cost-benefit analysis focuses on three main components: investment climate/integration into the global economy, divestiture/retrenchment program, and international competitiveness. For purposes of the analysis, the "integration into the global economy" subcomponent is factored in the investment climate. FIRMCAP, ASCAP and BIZCAP are also factored in the "international competitiveness" subcomponent. The numeraires used are output and employment income, which are expected to grow mainly as the result of increased productive investments, productivity, and greater access to export markets.

After running the model based on conservative assumptions given below, the project generates a net present value estimated at about US$22.6 million corresponding to an internal economic rate of return of 27.7 percent. The project is expected to positively affect employment as a result of increased demand for labor in all the sectors supported. However, the relatively low capacity utilization rate of 68 percent would slow down the rate of job creation. That said, during the lifetime of the project, a minimum of 4,500 direct jobs are expected to be created. This number does not take into account the number of indirect jobs creation which has not been estimated since the job multipliers are not known.

The government fiscal position is also positively affected. Indeed, for the 12-year forecast time frame, the project would generate $5.9 million as the result of incremental personal income taxes, corporate income taxes. This amount does not take into account divestiture proceeds.

For all the projects components, as shown in table 1 below, the NPVs are positive indicating that the project is robust.

Table 1: Results by components (12-year forecast timeframe)

	Investment climate / Integration into the world economy	Divestiture	Retrenchment	International competitiveness	BIZPLAN / SCHOOLCAP	Overall Project [a]
NPV (US$ million)	1.9	1.8	8.4	9.3	2.2	22.6
ERR (%)	35.2	19	23.7	38.4	27.7	27.7

[a] The overall ERR is weighed by the relative size of each component.

Main Assumptions and parameters (in the base case scenario):[36]

(i) 7,000 workers will be retrenched. The average amount of severance package is estimated at US$2,000. GOE's contribution to this retrenchment program, in the base case scenario, is US$7 million. An additional 3,000 workers are expected to be retrenched during project implementation but the sources of funding are not identified at this stage.

(ii) Value added per worker is US$2,390. The average minimum salary is US$690.

(iii) The average capacity utilization rate is estimated at 68 percent. The rates of job creation has been calculated taking into account a yearly worth of output per worker of US$2,390. The rates are discounted to take into account the relatively low capacity utilization rate.

(iv) 578 beneficiaries will be supported by the BIZZCAP matching grant with an average grant amount of US$10,000.

(v) WTO Accession will stimulate foreign direct investments at a multiple of 10 times the amount of support. It is obviously not easy to estimate the quantitative impact of the improvement in the business environment as well as the greater insertion into the world economy. For that reason we make the simple assumption that financial costs and benefits can be equated with the economic costs and benefits of the operations of assisted firms. We make the conservative assumption that the support provided would yield an increase in economic outputs at a multiple of 2 times the amount of support.

(vi) 1,000 beneficiaries are expected to participate to the BIZZPLAN. The yearly average number of BIZZPLAN winners is 11. The average amount of the award received by the winner is US$15,000.

(vii) In the base case, the increase in firms' output is discounted by two-thirds to take into account the social costs of other resources in the economy that are diverted into the project from other activities not directly supported by the project.

[36] These assumptions will be used during project implementation for benchmarking and to facilitate comparison of the results of the cost-benefit analysis that will be carried out at project closing. The M&E system is expected to regularly collect all the relevant data.

Sensitivity Analysis:

Four sensitivity tests were carried out by changing values of critical variables and parameters. The results are presented in table 3 below.

(i) The first test decreases the social cost of resources diverted into the project from 66 percent to 50 percent; the NPV jumped to US$54.6 million with a corresponding IRR of 44.0 percent. 5,800 jobs are created during the 5-year lifetime of the project.

(ii) The second test assumes a 75 percent social cost of resources diverted into the project, the NPV considerably decreased to US$7.6 million while the IRR dropped to 18.0 percent. About 3,750 jobs are generated during the 5-year lifetime of the project.

(iii) The third test assumes a higher increase in output for each firm from 5 to 10 for the MSMEs benefiting from the BDS; The results showed a NPV of US$38.2 million and IRR of 37.1 percent. 7,280 jobs are created during the 5-year lifetime of the project.

(iv) The fourth test elongates the disbursement period by two years, the NPV decreased to US$13.7 million while the IRR came down to 23.4 percent. The number of jobs created remains the same as in the base case with however a slightly lower rate of job creation.

The fiscal impact is positive in all the scenarios.

Table 3: Sensitivity Analysis Summary (12-year forecast timeframe)

Scenario	Sensitivity Performed	Cases	Variable Amount	NPV ($million)	IRR (%)	Fiscal Impact ($million)	Jobs created (5-year)
Overall Project							
Delayed Project Implementation	Elongated Disbursement period	(a) Base	(a) Regular Disbursement	22.6	27.7	5.9	4,500
		(b) Alternate	(b) Slow Disbursement	13.7	23.4	5.0	4,500
Change in Diversion Assumption	Percent reduction in increase in Output attributed to diversion from other sources	(a) Base	(a) 66% Reduction	20.1	31.2	6.7	4,500
		(b) Alternate	(b) 75% Reduction	7.6	18.0	3.7	3,760
		(d) Alternate	(c) 50% Reduction	54.4	44.0	10.8	5,800
Expected Change in Output for the BDS beneficiaries	Increase in expected change in output for the BDS beneficiaries	(a) Base	(a) 5 Times	20.1	31.2	6.7	4,500
		(b) Alternate	(b) 10 Times	38.2	37.1	9.4	7,280

Benefits from the project

The main economic benefits and the monitoring tools are presented below:

Nature of benefits / Indicators	Monitoring Tools
Increased productivity and outputs in supported SMEs	Base case / end of project output levels (control MSME group)
Improved investment climate	Follow up investment climate assessment
Job creation in the supported SMEs	Number of employees at beginning / end of project in the relevant SMEs
Increase trade	Statistics from the Ministry of Trade
Improved productivity of divested companies	Statistics from the Ministry of Finance
Higher fiscal revenues Privatization proceeds	Statistics from the Ministry of Finance

Annex 10: Safeguard Policy Issues

ETHIOPIA: Private Sector Development Capacity Building

Environmental Category: B (Partial Assessment)

Introduction
The Government of Ethiopia is involved in redefining its role in the economy, while reducing the financial and administrative burden of the PE sector on the Government. Therefore, acceleration of the privatization program has been identified as a priority measure that can contribute to improve the economy's competitiveness. By supporting these reforms, GOE aims to achieve the objective of poverty reduction through broad-based economic growth led by the private sector.

At the end of 2003, the PE sector comprised of 149 enterprises, excluding utilities, banking and insurance, of which 138 have been slated for privatization. As part of the privatization process, the environmental issues at the PEs have been addressed during project preparation by conducting an environmental pre-audit of the PEs selected for privatization to analyze existing conditions at and around specific sites of the enterprises to select PEs requiring full and partial environmental audits to be undertaken. The work was funded under the PHRD grant. The field work, including visits to PEs, was carried out during the month of October, 2004 by a team of local experts led by a Lead Consultant.

Objectives
The primary objectives of the environmental pre-audit are to: (i) measure the environmental and social conditions, for both past and on-going activities, of the selected enterprises against the risk of being held responsible for damage; (ii) determine the need for remedial actions necessary to bring a given enterprise into compliance with national and Bank safeguard policies prior to privatization; and (iii) formulated recommendations for partial and full audits for each facility or site, as applicable, and suggest a framework for subsequent audits.

The secondary objectives were to determine the role and responsibilities of the regulatory and the legislative bodies in Ethiopia on the identified environmental liabilities of the PEs, and assess the training capacity needs for environmental management of the enterprises.

Environmental setting
Ethiopia's flora and fauna have been significantly affected by accelerated and unplanned industrial and agricultural development: deforestation has increased considerably due to population pressures particularly in the highlands; industrialization with little environmental control or compliance has increasingly polluted most of Ethiopia's 12 rivers and basins, especially in or around the Addis Ababa, Mojo, Debre Zeit, and Kombolcha regions. Other environmental issues of concern include soil degradation, and overgrazing. In addition, around the country there is also relatively low coverage and access to basic services such as electricity, water supply and sanitation, drainage, and solid waste collection and its environmental disposal.

The environmental problems in Ethiopia are further complicated by inadequate management of wastes containing toxic elements and poor work ethics; inadequate waste treatment, and poor water and air quality; poor sanitation, drainage, and solid waste services and management; poor industrial hygiene; and poor industrial waste management. Furthermore, there is also a serious lack of addressing of worker health and safety issues, including medical monitoring and providing appropriate industrial hygiene for workers. Hence, the essential elements are not adequately in place to minimize the negative effects deriving from the environmental concerns affecting the country.

Indeed, the site visits during the Environmental Pre-audit indicate that a number of PEs, in particular the sugar, tanneries, and textile mills, have been impacting negatively on the environment primarily with noise, waste oil spills, asbestos released, smoke in the air, and contamination of the ground water. In most cases, the untreated wastewater had been and is being discharged into open drains or in a few cases, into city sewers, thereby negatively impacting the quality of life of residents.

Statutory and Institutional Framework
Ethiopia has a number legislative and compliance requirements governing environmental management issues:

(i) *Provisional Standards for Industrial Pollution Control in Ethiopia* issues in 2003, which attempts to integrate environmental management into the national policies for development.
(ii) *Environmental Pollution Control Proclamation No. 300/2002*, which states that "no person shall pollute or cause any other person to pollute the environment by violating the relevant environmental standards."
(iii) *Public Health Proclamation No. 200/2000*, which prohibits to discharge untreated liquid wastes generated from the septic tanks, seepage pits, and industries into water bodies, or water convergences; prohibits disposal of solid or liquid or any other waste in a manner which contaminates the environment or affects the health of the society; and mandates any employer to ensure the availability of occupational health services.
(iv) *Labor Proclamation No. 42/93*, which states that "an employer shall take the necessary measures to safeguard adequately the health and safety of workers."
(v) *Water Resource Management Proclamation 197/2000*, which prohibits to release or discharge any waste, which endangers human life, animals, plants and any living things into water resources.

The Agency, since its inception in 1995, has been continuously improving the environmental management initiatives. However, it is still required to develop and refine: (i) the specific EHS guidelines and regulations to accommodate the different sectors; (ii) methodologies for monitoring waste and toxic products in industrial effluents; and (iii) standards for monitoring environmental parameters.

Two agencies are involved in the environmental management issues. The Federal Environmental Protection Authority (FEPA) has the responsibility for overall management of Ethiopia's environment. PPESA, although it does not have an environmental regulatory or management authority, nor does it invest in both public and private enterprises and environmental clean-up activities, has an important role to play as the lead agency in charge of the privatization program as there are important EHS dimensions of collective and individual privatization transactions that must be timely and diligently taken into account during preparation and implementation of privatization process.

Therefore, a close collaboration between FEPA and PPESA will be necessary during the implementation of the privatization program. Both agencies must implement compliance and post-privatization monitoring, and implement and enforce applicable laws and regulations on enterprises' new owners. Also the new investors or owners must adhere to the highest standards of safe and sound operation for protection of not only the environment, but also the employees and the people in communities where privatized enterprises are located and do business. Compliance with Ethiopian EHS legislation, rules, regulations, and standards, as well as applicable international obligations, would need to be assured and enforced. This will require an adequate technical and management capacity on the part of the PPESA as well FEPA.

Selection of PEs for Environmental Audits
In order to determine the level of audit required by each of the PEs under study (i.e., full, partial or pre-audit), PEs were ranked based on their risk characteristics. The risk characterization is a process of estimating the probable incidence of adverse impacts to potential receptors under various exposure conditions including an elaboration of uncertainties associated with such estimates. The ranking is based on the qualitative estimation of the potential risks and/or hazards due to activities carried out by each of the PEs.

The checklist was developed covering all key elements that were evaluated during an audit, including (1) the production process, including the flow diagrams, the major pollutants at each stage, etc.; the byproducts; the types and quantities of chemicals used, and the production capacity; (2) types and quantities of wastes generated; (3) pollution from noise, dust, blast, and vibrations; (4) procedures to manage wastes including pre-treat merit; and (5) occupational safety and health issues.

The rating components for evaluating and characterizing the audit level of a PE were based on:

(i) Type of Enterprises (i.e., activities at facilities and sites);
(ii) Emissions and Air Quality;
(iii) Wastewater (i.e., impact on surface water and ground water receptors);
(iv) Waste Oil and Spill Control Measures;
(v) Solid Waste;
(vi) Noise, dusts, etc.;
(vii) Occupational Health and Safety Issues;
(viii) Environmental Management and Regulatory Framework; and
(ix) Capacity Building, Training, and Awareness (of environment and also of the proposed privatization).

The audit evaluation factors were assigned rating components ranging from one (1) to ten (10); with the least significant rated as 1 and the very significant rated as 10. The audit factors were incorporated into a relative ranking scheme that used a combination of weights and ratings to produce a numerical value called the Audit Index. Then, the weighting was assessed on the overall effects to pollution potential for the sites and facilities of the PEs by considering the weighting components such as depth to water; impact on land-use and planning; soil and aquifer media; topography; impact on wetlands and water bodies; and impact on workers.

The PEs reviewed were assigned scores on the basis of the Audit Index Factors (AIF) developed for the various facilities. The AIF is a degree of pollution potential for a facility by which assessment for comprehensive audits can be determined. The environmental parameters with little impact on the environment were assigned the lowest score of one (1). The criteria with signification impact on the environment were assigned the highest score of ten (10). The scores for each enterprise were then summed and the site with the highest total score was designated the most likely site to have a fill audit undertaken.

Thus, each audit factor has a relative weight ranging from one (1) to five (5); the least significant with a weight of 1 and the very significant with weight of 5. For example, a component such as "Air Emission" was assigned a weight of 5 if the impact to the environment was very significant, (such as burning used oil in an enclosed room, a situation observed at the Nazareth Edible Oil Factory). A weight of 1 was assigned if the impact to the environment was of least significance. To obtain the number of each of AIF that determined the degree of the pollution potential, the weight was multiplied by the rating. The total of the product for each individual Audit Factor equals the Audit Index. Evaluation of the Audit Index for the PEs provided the relative significance of each facility with respect to the pollution potential.

Based on the cumulative Audit Index Factors, the PEs were ranked into categories of those considered as high risk, thereby requiring comprehensive (full) audits (AIF of cumulative scores above 140), those considered as medium risk thereby requiring partial audits (AIF of cumulative scores ranging from 100 to 140), and those considered as low risk thereby requiring no audits, i.e., where the current pre-audit was considered sufficient (AIF of cumulative scores below 100).

Results

As a result of the environmental pre-audit, 24 PEs will require full environmental audits and remediation plans and 72 PEs will require partial audits. The Government and IDA agreed that the PSD CB project under Component One, will provide funding to cover, at a minimum, the costs of conducting full or partial audit for larger transactions for 55 selected PEs (see Table 3). Environmental Management Plans will also be prepared as part of the environmental study where necessary. These will assist PPESA and FEPA in negotiating compliance agreements with new investors where PEs do not meet existing standards at the time of their privatization. If required, the project will fund a training needs assessment of the FEPA and its implementation to build its capacity. The Government agreed that the environmental audits will also be conducted for the remaining PEs utilizing the project funds or from other donors.

Table 3: List Of Public Enterprises to be supported by the PSD CB Project

No	Enterprises Name	Total Assets (000) Birr	Environmental Audit
1	Coffee Plantation Dev't	613,395	P
2	Bale Agricultural Dev't Ent.	250,360	F
3	Upper Awash Agro Industry	238,000	P
4	Middle Awash Agri.Dev't Ent.	196,000	P
5	Arsi Agricultural Dev't Ent.	185,000	F
6	Ethiopian Tannery Sc.Co.	174,178	F
7	Ethiopian Mineral Dev't Ent.	163,872	N
8	Dire Dawa Food Complex Sh. Co.	153,171	N
9	Semen Omo Agricultural Dev't Ent.	144,000	P
10	Addis Modjo Edible oil Factory	133,227	P
11	Nazareth Tractor Factory	124,407	P
12	Tabor Ceramics Factory	122,036	P
13	Blue Nile Construction Sh.Co.	108,703	N
14	Awassa Textile Sh.Co	103,772	F
15	Shebele Transport Sh. Co.	103,186	P
16	Kality Food Sh.Co.	95,092	P
17	Arbaminch Textile Sh.Co.	92,777	P
18	Awash Construction Ent.	88,515	No entry given
19	Awassa Agricultural Dev't Ent.	86,557	F
20	Tendaho Agricultural Dev't Ent.	78,000	P
21	Akaki Metal	72,652	P
22	Dire Dawa Textile Factory	67,000	F
23	Batu Construction Ent.	66,977	P
24	Fafa Food Sh.Co.	65,635	P
25	Edget Yarn & Sew. Thread Sh.Co.	63,563	F
26	Kality Metal Products	63,430	N

No	Enterprises Name	Total Assets (000) Birr	Environmental Audit
27	Bahirdar Textile Sc.Co.	60,648	F
28	Debre Birhan Blanket Factory	54,278	P
29	Akaki Textile Sh.Co.	52,377	F
30	Ethiopian Iron Foundary	47,157	F
31	Water Will Drilling Ent.	41,449	P
32	Ethiopian Fiber Products Factory	41,266	N
33	National Engineres & Contructors	40,000	P
34	Tikur Abay Shoe Sh.Co. Blue Nile Shoe	37,977	N
35	Modjo tannery Sh.Co.	33,831	F
36	Horticulture Dev;t Ent.	30,495	P
37	Addis Ababa Tannery Sh.Co.	30,161	P
38	Nazareth Garment Sh.Co.	30,000	N
39	Anbessa Shoe Factory	29,503	N
40	Mehere Fiber Pro. Factory	28,503	P
41	Abjata Soda Ash Factory	27,644	N
42	Ethuo-Japan Synth. Textile Sh.Co.	26,195	F
43	Coffee Tec. Dev't 7 Eng. Ent.	25,291	P
44	Prefab. Building Parts production Ent.	22,987	P
45	Eth. Canavas & Rubber Shoe Sh. Co.	22,725	F
46	Adei Ababa Yarn Sh.Co.	22,203	F
47	Housing Construction Ent.	19,497	N
48	Combolca Textile ShCo.	15,100	F
49	Akaki Garment Sh.Co.	14,000	N
50	Combolch Shoe Sh.Co.	9,148	No entry given
51	Gullele Garment Sh.Co.	9,000	N
52	Addis Garment Sh.Co.	6,609	N
53	Adama Edible Oil Factory	6,103	P
54	Abobo Agrcultural Dev't Ent.	5,000	F
55	Gonder Printing Ent.	4,125	No entry given
	GRAND TOTAL	**4,446,777**	

Annex 11: Project Preparation and Supervision

ETHIOPIA: Private Sector Development Capacity Building

	Planned	Actual
PCN review	0/12/2004	09/16/2004
Initial PID to PIC	09/28/2004	11/01/2004
Initial ISDS to PIC	09/28/2004	11/01/2004
QER Meeting		10/18/2004
Appraisal	11/15/2004	11/01/2004
Negotiations	11/25/2004	11/17/2004
Board/RVP approval	12/21/2004	12/21/2004
Planned date of effectiveness	03/30/2005	
Planned date of mid-term review	06/30/2007	
Planned closing date	06/30/2011	

Key institutions responsible for preparation of the project: Ministry of Trade and Industry.

Bank staff and consultants who worked on the project included:

Name	Title	Unit
Agata Pawlowska	TTL, Economist	AFTPS
Phillip English	Senior Economist	WBIPR
Rughvir (Shyam) Khemani	Adviser	CICDR
Andrew Singer	PSD Specialist	Consultant
Michael Opagi	Privatization Expert	Consultant
Bruce Carrie	Privatization Expert	Consultant
Michael Graglia	Project Officer	Global Business School Network, IFC
Joyita Mukherjee	Sr. Corporate Strategy Officer	Corporate Strategy Group, SFRCI
Menbere Tesfa Taye	PSD Specialist	AFTPS
Andrea Vasquez-Sanchez	Sr. Program Assistant	AFTPS
Irene Chacon	Operations Analyst	AFTPS
Shenaz Ahmed	Program Assistant	AFC06
Yeshi Dagne	Program Assistant	AFTPS
Dileep Wagle	Lead PSD Specialist	AFTPS
Amadou Konare	Environmental Specialist	AFTS1
Thomas Walton	Regional Safeguards Coordinator	AFTS1
Mbuba Mbungu	Lead Procurement Specialist	AFTPC
Samuel Haile Selassie	Procurement Specialist	AFC06
Solange Aliali	Sr. Counsel	LEGAF
Steven Gaginis	Lead Disbursement Specialist	LOAG2
Eshetu Yimer	Sr. Financial Management Specialist	AFC06
Ibrahima Dione	Consultant	Consultant
Amadou Dem	Young Professional	AFTPS
Nikolay Mandinga	Junior Professional Associate	AFTPS

Name	Title	Unit
Quality Advisors		
Iradj Alikhani	CPC and Lead PSD Specialist	AFCSN
Magdi Amin	Senior PSD Specialist	EASFP
Richard Cambridge	Operations Adviser	AFTOS
Luke Haggarty	Senior Economist	LCSFR
Herminia Martinez	Consultant	AFTPS
Edgar Saravia	Country Manager	ACCU7
Gaiv Tata	Lead Financial Analyst	AFTPS

Bank funds expended to date on project preparation:

1. Bank resources: US$200,000
2. Trust funds: -
3. Total: US$200,000

Estimated Approval and Supervision costs: US$120,00

1. Remaining costs to approval: -
2. Estimated annual supervision cost: US$120,00

Annex 12: Documents in the Project File

ETHIOPIA: Private Sector Development Capacity Building

A. Bank Staff Assessments

Identification Aide Memoire - 5-16 April, 2004
Preparation Aide Memoire - 29 June - 10 July, 2004
Pre-Appraisal Aide Memoire - 11-24 September, 2004
Appraisal Aide Memoire - 1-11 November, 2004
World Bank Policy Note of Principles and Approach to Privatization in Ethiopia - 2004
Investment Climate Assessment (ICA) - 2002
Investment Climate Assessment Update - 2004
Diagnostic Trade Integration Support (DTIS) - August 2004
Country Economic Memorandum (CEM) - October 24, 2004, Report No. 29383
Country Assistant Strategy (CAS) - March 2003
Country Assistant Progress Report - August 25, 2004
PRSC1 Project Appraisal Document - January 20, 2004

B. Government Documents

Sustainable Development & Poverty Reduction Program (SDPRP) - August 2004
Industrial Development Strategy - August 2002
Economic Development Research Institute (EDRI) - Survey on MSMEs - January 2004
PHRD funded studies on MGS, Associations, WTO Road Map - August to November 2004
Central Statistic Agency (CSA) - Survey of Large and Medium Scale Manufacturing Industries - April 2002.

C. Other Documents

"Doing Business in 2005. Removing Obstacles to Growth"
"World Development Report 2005: A Better Investment Climate For Everyone."
An Investment Guide to Ethiopia. Opportunities and Conditions, UNCTAD, March 2004
Study on Low Investors' Interest in Ethiopia and Institutional Support of EPA (July 2003) and a follow-up position paper on the Ethiopia Privatization Program - March and July 2003
ADB Special Country Report # 5: Private Sector Development in Ethiopia and the Role of ADB.
EU MSEDP Program Document - August 2002
Higher education development for Ethiopia : pursuing the vision 2004/04/01, Report # 29096 WBG Working Paper

Annex 13: Statement of Loans and Credits

ETHIOPIA: Private Sector Development Capacity Building

Closed Projects	70		
IBRD/IDA (US$ Millions)		Total Disbursed (Active + Closed)	3577.0
Total Disbursed (Active)	1124.4	of which has been repaid	417.5
of which has been repaid	0.0	Total Undisbursed (Active)	1113.3
Total Disbursed (Closed)	2452.6	Total Undisbursed (Closed)	0.0
of which has been repaid	417.5	Total Undisbursed (Active + Closed)	1113.3

Active Projects

		Last PSR Supervision Rating			Original Amount in US$ m				Expected and Actual Disbursements b/	
Project ID	Project Name	Development Objectives	Implementation Progress	Fiscal Year	IDA	GEF	Cancel.	IDA Undisb. a/	Orig.	Frm Rev'd
P069083	Global Distance Learning	U	U	2001	4.9		3.1	1.7	5.2	0.3
P050938	Capacity Building For Dec. Serv. Del.	S	U	2003	26.2			27.7	17.9	
P081773	Emerg Drought Recovery	S	S	2003	60.0			13.3	1.4	
P067084	Emergency Recovery And Rehab.	S	S	2001	230.0			82.8	62.7	
P035147	Conserv.& Sustain. Use Medic. Plants	S	S	2001		1.9	0.0	1.5	1.0	
P057770	Cultural Heritage	S	S	2002	5.0			5.3	2.0	
P000736	Energy Ii	S	S	1998	200.0			12.6	16.3	
P075915	Pastoral Community Development	S	S	2003	30.0			29.0	0.8	
P082998	Road Sec. APL II	#	#	2005	160.9			161.1		
P049395	Energy Access	S	S	2003	132.7			147.9	71.1	
P050383	Food Security	S	S	2002	85.0			90.8	-9.9	
P078692	Post Secondary Education	#	#	2005	40.0			40.2		
P074020	Public Sector Cap Bldg	#	#	2004	100.0			98.7	2.7	
P044613	Road Sec. APL I	S	S	2003	126.8			121.1	6.6	
P076735	Water Supply & Sanitation	S	S	2004	100.0			99.3	0.1	
P050342	Women Dev Initiatives	S	S	2001	5.0			2.7	1.4	0.9
P000733	Ag. Research & Training	S	S	1998	60.0			14.6	13.5	
P052315	Conservation Of Medicinal Plants	S	S	2001	2.6			1.9	-1.0	
P073196	Demobilization And Reintegration Proj	S	S	2001	170.6			33.5	27.2	
P000755	Ethiopia Road Sec. Dev. Prog.	S	S	1998	309.2			36.2	37.7	33.1
P000756	Health Sector Dev.	S	S	1999	100.0			18.5	15.9	
P078458	ICT Assisted Development Project	#	#	2005	25.0			25.1		
P069886	Multisectoral HIV/AIDS	S	S	2001	59.7			25.5	40.2	
P000771	Social Rehab. (ESRDF I)	S	S	1996	148.3		11.5	23.8	15.9	32.4
	TOTAL				2181.9	1.9	14.6	1114.8	328.7	66.7

Legend: HS = Highly satisfactory; S = Satisfactory; HU = Highly unsatisfactory; U= Unsatisfactory

a) Undisbursed balance may exceed IDA $US denominated commitment due to SDR appreciation since commitment.

b) Intended disbursements to date minus actual disbursements to date as projected at appraisal.

IFC and MIGA Program for Ethiopia
As of November 16, 2004

	2000	2001	2002	2003
IFC approvals (US$m)	0.0	0.0	25.0*	0.0
Sector (%)				
Food and agri-business	--	--	100	--
Investment instrument (%)				
Loan	--	--	60	--
Equity	--	--	40	--
MIGA guarantees (US$m)	0.0	0.0	0.0	0.0

** Total IFC investment in Coca-Cola SABCO for five countries: Ethiopia, Kenya, Uganda, Tanzania, and Mozambique*

Statement of IFC's Held and Disbursed Portfolio
As of November 16, 2004

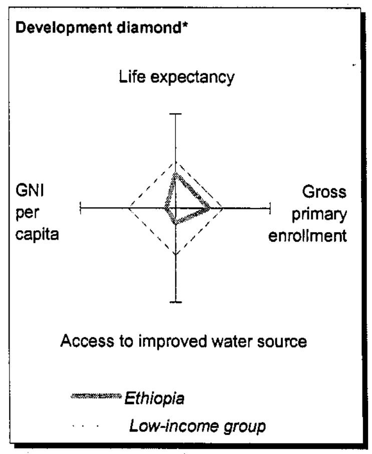
Year	Borrower/Purpose	Original Gross Commitments			
		Loan	Equity	Participant	Total
1965-73	Dire Dawa (Spinning, weaving and finishing)	2.4	1.4	1.1	4.8
1966	Ethiopian Pulp (Manuf. of pulp paper and paperboard)	0.0	1.9	0.0	1.9
1968	Metahara (Sugar factories and refineries)	4.9	3.5	0.7	9.0
1989	Red Sea (Crude petroleum and natural gas)	0.0	7.8	0.0	7.8
2002	Coca-Cola SABCO (Ethiopia, Kenya, Uganda, Tanzania, Mozambique)	15.0	10.0	0.0	25.0
Total gross commitments 1/		22.3	24.6	1.7	48.6
Less: cancellations, terminations, repayments and sales		7.3	14.6	1.7	23.6
Total commitments now held		15.0	10.0	0.0	25.0

Annex 14: Country at a Glance

ETHIOPIA: Private Sector Development Capacity Building

9/2/04

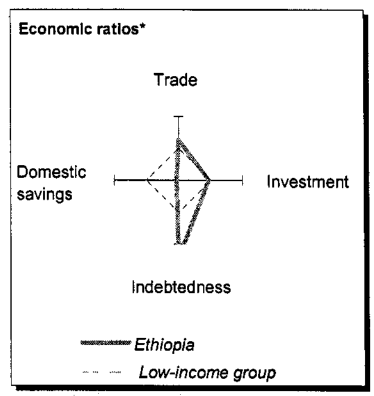
POVERTY and SOCIAL	Ethiopia	Sub-Saharan Africa	Low-income
2003			
Population, mid-year *(millions)*	68.6	703	2,310
GNI per capita *(Atlas method, US$)*	90	490	450
GNI *(Atlas method, US$ billions)*	6.4	347	1,038
Average annual growth, 1997-03			
Population *(%)*	2.3	2.3	1.9
Labor force *(%)*	2.2	2.4	2.3
Most recent estimate (latest year available, 1997-03)			
Poverty *(% of population below national poverty line)*	44	..	..
Urban population *(% of total population)*	16	36	30
Life expectancy at birth *(years)*	42	46	58
Infant mortality *(per 1,000 live births)*	114	103	82
Child malnutrition *(% of children under 5)*	47	..	44
Access to an improved water source *(% of population)*	24	58	75
Illiteracy *(% of population age 15+)*	57	35	39
Gross primary enrollment *(% of school-age population)*	64	87	92
Male	75	94	99
Female	54	80	85



KEY ECONOMIC RATIOS and LONG-TERM TRENDS

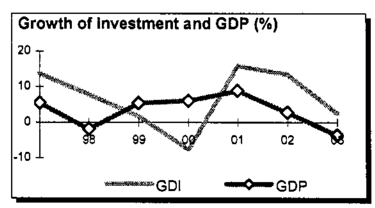
	1983	1993	2002	2003
GDP *(US$ billions)*	6.1	6.2	6.1	6.7
Gross domestic investment/GDP	11.9	14.2	20.5	20.5
Exports of goods and services/GDP	9.1	8.1	16.2	17.1
Gross domestic savings/GDP	5.2	2.1	2.5	1.0
Gross national savings/GDP	6.9	10.9	14.8	15.8
Current account balance/GDP	-5.1	-3.3	-5.7	-4.7
Interest payments/GDP	0.4	0.4	0.7	0.6
Total debt/GDP	63.5	155.3	107.6	..
Total debt service/exports	18.3	17.9	10.4	9.9
Present value of debt/GDP	..	..	..	..
Present value of debt/exports	..	..	..	..

	1983-93	1993-03	2002	2003	2003-07
(average annual growth)					
GDP	0.9	4.7	2.7	-3.7	6.8
GDP per capita	-2.1	2.1	0.5	-5.6	6.6
Exports of goods and services	-0.8	11.4	13.1	18.9	3.6

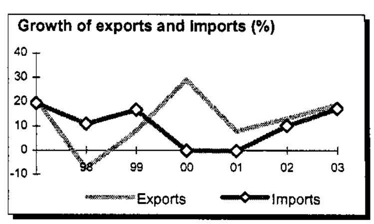


STRUCTURE of the ECONOMY

	1983	1993	2002	2003
(% of GDP)				
Agriculture	55.7	59.6	42.3	41.8
Industry	12.0	9.6	11.1	10.7
Manufacturing	7.3	6.1	..	..
Services	32.4	30.8	46.5	47.4
Private consumption	78.6	87.6	78.1	75.2
General government consumption	16.2	10.2	19.3	23.8
Imports of goods and services	15.9	20.2	34.2	36.5



	1983-93	1993-03	2002	2003
(average annual growth)				
Agriculture	1.8	1.6	-2.3	-12.6
Industry	-3.0	4.8	5.8	4.6
Manufacturing	-4.0	4.8	4.1	3.6
Services	1.6	7.4	4.6	2.3
Private consumption	2.0	2.1	-3.1	-9.2
General government consumption	-3.2	15.7	19.5	16.6
Gross domestic investment	-0.5	6.4	13.3	2.4
Imports of goods and services	1.2	7.8	10.0	17.1

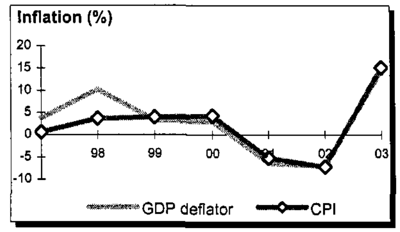


Note: 2003 data are preliminary estimates.

* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

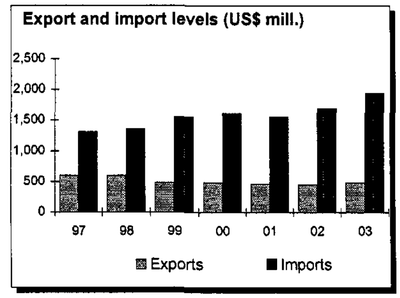
PRICES and GOVERNMENT FINANCE

	1983	1993	2002	2003
Domestic prices				
(% change)				
Consumer prices	3.8	10.0	-7.2	15.1
Implicit GDP deflator	3.1	13.2	-7.0	14.5
Government finance				
(% of GDP, includes current grants)				
Current revenue	18.6	12.7	22.6	25.4
Current budget balance	-1.6	-0.2	2.3	1.7
Overall surplus/deficit	-11.6	-6.9	-11.3	-10.5



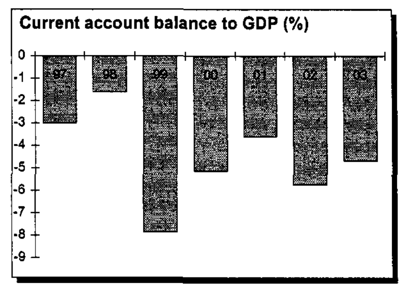
TRADE

	1983	1993	2002	2003
(US$ millions)				
Total exports (fob)	391	222	452	483
Coffee	240	126	163	165
Leather and leather products	21	1	66	66
Manufactures	81	40	67	72
Total imports (cif)	856	1,052	1,696	1,940
Food	..	167	209	316
Fuel and energy	..	198	268	288
Capital goods	..	404	523	618
Export price index *(1995=100)*	83	65	53	52
Import price index *(1995=100)*	105	93	113	122
Terms of trade *(1995=100)*	79	70	47	42



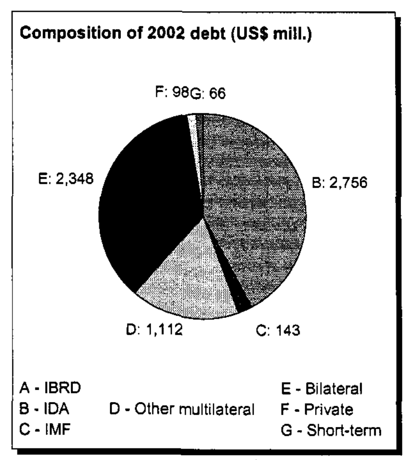
BALANCE of PAYMENTS

	1983	1993	2002	2003
(US$ millions)				
Exports of goods and services	552	507	983	1,140
Imports of goods and services	961	1,263	2,073	2,431
Resource balance	-410	-756	-1,091	-1,291
Net income	-14	-96	-40	-55
Net current transfers	117	648	783	1,035
Current account balance	-306	-204	-347	-310
Financing items (net)	234	286	632	573
Changes in net reserves	72	-81	-285	-262
Memo:				
Reserves including gold *(US$ millions)*	206	411	664	931
Conversion rate *(DEC, local/US$)*	2.1	4.3	8.5	8.6



EXTERNAL DEBT and RESOURCE FLOWS

	1983	1993	2002	2003
(US$ millions)				
Total debt outstanding and disbursed	3,845	9,703	6,523	..
IBRD	44	7	0	0
IDA	342	1,187	2,756	2,956
Total debt service	108	95	108	120
IBRD	8	7	0	0
IDA	4	15	17	22
Composition of net resource flows				
Official grants	150	562	..	..
Official creditors	785	341	548	535
Private creditors	38	-27	-4	-4
Foreign direct investment	-3	4	..	..
Portfolio equity	0	0	0	..
World Bank program				
Commitments	96	346	343	..
Disbursements	42	230	465	362
Principal repayments	5	13	5	12
Net flows	37	217	460	350
Interest payments	6	8	12	11
Net transfers	31	209	447	340



MAP SECTION