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1. Country and Sector Background

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 socialist Derg government which ruled Ethiopia for over 20 years. 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), improve access to infrastructure (telecom, 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 for firms 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 a set of 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. 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 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. 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. Nonetheless, a number of areas remain to be addressed, of which the most important are:

(i) Cumbersome tax regime; limited access to land, utilities (electricity, water) and credit; and poor quality of public services (at federal and/or municipal level)[1], all of which contribute to the costs of doing business.
(ii) Environment that inhibits competitive processes and preserves the dominance of the PE sector, and lack of a level playing field, resulting in crowding out of private sector.
(iii) The slow pace of implementation of the PSD reform agenda, which contributes to investor perception of risk.
(iv) Environment that does not adequately promote improvements in firms' skills and productivity.

There is a commitment from the Government to continue the implementation of the first-generation reforms necessary to remove main bottlenecks to PSD and aim to create pre-conditions for growth. 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, etc.).

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[1] such as: customs clearance for imports, certification of goods and services, inspections (fire, sanitary, etc), access to construction permits.

The proposed PSD Capacity Building (PSD CB) 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 achieve 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 barriers 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.

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.[2] 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 the 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 the 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 crowding out the private sector and curbing its growth in terms of number and size of firms, which are small compared to the country's size and comparing to international standards.[3]

(ii) Weak integration of Ethiopian economy into the regional and international economy, which manifests itself in 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 capacity and labor productivity of the private sector to compete and weak institutional support to PSD. While the cost of labor is very low, compared to some leading countries exporting

[2] Among them are: (i) ICA, 2002; (ii) DTIS, 2003; (iii) CEM, draft in 2004; (iv) EDRI survey MSMEs of 2004.
[3] According to ICA results (2002), median surveyed firm hired only 14 employees compared to 251, 20, and 210 for China, Kenya, and Bangladesh, respectively.

labor-intensive manufactures,[4] 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 to address the above constraints that relate to policies and institutions by providing technical and financial assistance aiming to roll back the government, improve business climate, support stronger integration of the Ethiopian economy into the regional and international markets and increase the capacity and 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 90s, particularly since 1997 (CEM). During a decade of 1993-2003, the administration and 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.

In the services area, all the utilities and transport are state monopolies; the banking and insurance sector are either under state monopoly or extended 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 manufacturing sector, which is considered by the Government as an important source of economic growth outside of agriculture, is also 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.[5] 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.[6] Forty one PEs are reported to have been tendered but not sold. During 2001-03 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

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[4] A median manufacturing wage rate is almost 30 percent that in China and about 40 percent lower than that in Bangladesh.

[5] 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.

[6] 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 120 were unbundled from three enterprises) and the total sales proceeds amounted to Birr 4.1 billion, 70 percent of which was accounted for by 8 transactions.

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, to the cumbersome procedures governing the process and to 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 pick up pace 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.

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). 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) seem to confirm the hypothesis 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. An additional difficulty arises from the widespread operations of the, so called, “foundation” or “party-affiliated” companies, which seem to have preferential access to contracts, information and finance.

In addition, 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 discussed in the section concerning the privatization program, it will also be necessary to undertake other 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 they are foreign or domestic, public or private, or for profit or not).

The Government has started the process towards an effective policy to increase 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 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 – FDI increased only slightly from $105 million in 2001/02 to $189 million in 2002/03. 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 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 through implementing policies and measures facilitating trade and investment, as recommended during the Diagnostic Trade Integration Study (DTIS) consultations. As the 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 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. Ethiopia's 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, the Office of the Prime Minister will formally submit the Memorandum to the WTO, which will launch the accession process. Further, recognizing the size of the challenge ahead, the GOE has decided to create a well-staffed department devoted to this task within MoTI. The process of internal capacity-building is continuing and will be assisted by the public sector reform program as well as an 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 their three biggest problems.[7] 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 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 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. Objectives

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 a set of 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 will also support poverty reduction strategy dialogue and implementation of policy measures agreed in the framework of the PRSC.

The higher level 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.

3. 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 (ii) reducing vulnerability.[8] 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

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[7] 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.

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

way. The proposed PSD CB project 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 currently under preparation, 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 in an effective and timely manner. Thus, the project will serve as a catalyst for reforms. 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 the already ongoing efforts led by the Bank and other donors 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 continued to actively support 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).

As a result, the PSD CB project is designed so that it ensures full complementarity between the donor-funded activities in support of Government programs. 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), implementation of the COMESA regional integration agenda, and strengthening of the Quality and Standards Authority of Ethiopia (QSAE). The program will also complement the USAID proposed support which is concentrated on the legal and administrative dimensions of WTO accession, and as such, will add to the primarily economic emphasis of the Bank's inputs. 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.

4. Description

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

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 an excess labor 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 redundancy program.

This component will provide financial and technical assistance in the following areas:[9]

(i) *Institutional capacity building of 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 a range of services, including: (a) transaction advisors to assist PPESA at various stages in transactions from preparation through to closing for selected larger and more complex transactions; (b) full and partial environmental impact assessments, identified as required during the environmental pre-audit and, if required, (c) capacity building for the Environmental Protection Authority.

(iii) *Excess labor program* – This activity will assist in dealing with excess labor in public enterprises slated for privatization.[10] The program will be co-funded by Government and investors and will provide a package of benefits, which may comprise of voluntary redundancy, early retirement, counseling, retraining and out placement, for redundant workers. A short term consultancy will be funded to assist in the design of the program.

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

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[9] 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.

[10] 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.

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 their 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. It will provide technical assistance and training in two sub-components covering competition policy and WTO accession.

Subcomponent A – Implementation of Competition Policy

This 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 including the administrative procedures for handling complaints, selecting cases, conducting investigations, gathering evidence, protecting business confidentiality, measures safeguarding the rights and obligations of parties involved in competition case matters, remedies and fines, examination of widespread anticompetitive business practices and industry specific situations, engaging in 'competition advocacy' and other such matters deemed necessary for the effective implementation of competition law-policy. In addition, provision for the review, evaluation, and changes to improve the Proclamation is included.

(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 staff participation in short-medium term educational programs-courses, internships at cooperating counterpart competition agencies, workshops, etc.

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

Subcomponent B – Support to WTO Accession

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 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.

(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

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
(ii) at building the capacity of private business and professional associations and of chambers to better serve their members.
(iii) *BIZPLAN* – Business Plan Competition aimed to support and grow private small and medium enterprises (SMEs) in Ethiopia.
(iv) *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

This sub-component consists of two "windows." FIRMCAP, which 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 to helping firms 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. 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.

ASCAP 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. It aims at encouraging the use of outside expertise and of travel, to build capacity within associations and chambers.

Subcomponent B – SCHOOLCAP

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,[11] building their capacity will impact the private sector throughout Ethiopia.

SCHOOLCAP will upgrade the program curriculum as well as the resources required to implement the revision. 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

BIZPLAN, or Business Plan Competition, will assist GOE's efforts to support and grow private small and medium enterprises (SMEs) in Ethiopia. BIZPLAN Competitions have proved to be an excellent vehicle to identify and support promising small-scale projects in other countries.[12] 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 (credit from the private banks participating in the scheme). The TA and finance combination is designed to address the two main constraints to entrepreneurship growth. 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.

5. Financing

Source:		($m.)
BORROWER/RECIPIENT		
INTERNATIONAL DEVELOPMENT ASSOCIATION		24.00
	Total	24

[11] Approximately 75 percent of the students at FBE are teachers or civil servants, while the remaining 25 percent come from the private sector.

[12] 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.

6. Implementation

The PSD CB project was designed and will be carried out in close collaboration with other donors. Strong 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.

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, WTO and Competition Policy. The Faculty of Business Economics, University of Addis Ababa will be responsible for the implementation of SCHOOLCAP. For the BIZCAP and BIZPLAN, the agreed implementation arrangements will adhere to the Government's strategy, as stated in the SDPRP, to redefine the role of the state as a facilitator for private sector growth and investment. In this spirit, the management of these two subcomponents will be delegated to Enterprise Ethiopia (EE), a project office under MoTI that is dedicated to upgrading business skills within the country.

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. With membership from the public and the private sectors. The PPSC will be assisted by a small Project Coordination Unit located within MOTI.

7. 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 series. 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 a higher trajectory of growth. It has been recognized by the Government and the coming technical and financial assistance has been 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.

8. Lessons Learned from Past Operations in the Country/Sector

The project has been designed drawing on the World Bank's experience in Sub-Saharan Africa and other regions, and has benefited from the 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, 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.[13] Finally, the project was prepared in consultation and with contributions from the PSD Donor Technical Team.

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[13] Using PHRD funding, three workshops were organized on WTO accession, Matching Grant Scheme and Competition Policy.

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, unions, the PEs themselves and the general public on the need to improve key areas of the economy and increase investment for growth.[14] Secondly, it is 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

[14] 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.

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.

9. Safeguard Policies (including public consultation)

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]

10. List of Factual Technical Documents

N/A

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

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