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Report No: PGD481

INTERNATIONAL DEVELOPMENT ASSOCIATION

PROGRAM DOCUMENT FOR A

PROPOSED GRANT
IN THE AMOUNT OF US$1 BILLION
AND A
PROPOSED CREDIT
IN THE AMOUNT OF US$500 MILLION

TO

THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

FOR THE

ETHIOPIA FIRST SUSTAINABLE AND INCLUSIVE GROWTH DEVELOPMENT POLICY OPERATION

JULY 12, 2024

Macroeconomics, Trade and Investment
Eastern And Southern Africa

Federal Democratic Republic of Ethiopia

GOVERNMENT FISCAL YEAR

July 8 – July 7

CURRENCY EQUIVALENTS

(Exchange Rate Effective as of June 30, 2024)

Currency Unit: Ethiopian Birr (ETB)

US$1.00 = ETB 57.33

ABBREVIATIONS AND ACRONYMS

AfCFTA	Africa Continental Free Trade Area	FY	Financial Year
CAR	Capital Adequacy Ratio	GDP	Gross Domestic Product
CBE	Commercial Bank of Ethiopia	GHG	Greenhouse Gas
CCDR	Country Climate and Development Report	GLI	Green Legacy Initiative
COVID-19	Coronavirus Disease of 2019	HGER	Home Grown Economic Reform
CPF	Country Partnership Framework	ICR	Implementation and Completion Report
CPI	Consumer Price Inflation	IMF	International Monetary Fund
CRGE	Climate Resilient Green Economy strategy	L/C	Letter of Credit
DPO	Development Policy Operation	LCU	Local Currency Units
DSA	Debt Sustainability Analysis	LT-LEDS	Long Term Low Emissions Development Strategy
ECF	Extended Credit Facility	NBE	National Bank of Ethiopia
EEP	Ethiopian Electric Power	NDC	Nationally Determined Contributions
EEU	Ethiopian Electric Utility	NOP	Net Open Position
EIA	Environmental Impact Assessment	NPV	Net Present Value
EIH	Ethiopian Investment Holdings	PIM	Public Investment Management
EOP	End of Period	PPG	Public and Publicly Guaranteed
ESIA	Environmental and Social Impact Assessment	SOE	State-Owned Enterprises
ETB	Ethiopian Birr		
FDI	Foreign Direct Investment	VAT	Value Added Taxes
FX	Foreign Exchange		

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FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

Ethiopia First Sustainable and Inclusive Growth Development Policy Operation

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SUMMARY OF PROPOSED FINANCING AND PROGRAM

BASIC INFORMATION

Operation ID	Programmatic	If programmatic, position in series
P181591	Yes	1st in a series of 2

Proposed Development Objective(s)

To support the Government of Ethiopia's efforts to: (i) advance financial sector restructuring and trade liberalization; (ii) promote fiscal sustainability and transparency; and (iii) enhance social resilience and climate action

Organizations

Borrower:	Federal Democratic Republic of Ethiopia
Implementing Agency:	Ministry of Finance

PROJECT FINANCING DATA (US$, Millions)

Maximizing Finance for Development

Is this an MFD-Enabling Project (MFD-EP)? Yes

Is this project Private Capital Enabling (PCE)? Yes

SUMMARY

Total Financing	**1,500.00**

DETAILS

World Bank Group Financing

International Development Association (IDA)	1,500.00
IDA Credit	500.00
IDA Grant	1,000.00

IDA Resources (US$, Millions)

	Credit Amount	Grant Amount	SML Amount	Guarantee Amount	Total Amount
National Performance-Based Allocations (PBA)	500.00	1,000.00	0.00	0.00	1,500.00
Total	**500.00**	**1,000.00**	**0.00**	**0.00**	**1,500.00**

PRACTICE AREA(S)

Practice Area (Lead)

Macroeconomics, Trade and Investment

Contributing Practice Areas

Energy & Extractives; Finance, Competitiveness and Innovation; Social Protection & Jobs

CLIMATE

Climate Change and Disaster Screening

Yes, it has been screened and the results are discussed in the Operation Document

OVERALL RISK RATING

Overall Risk	High

Results

Indicator Name	Baseline (2023)	Target (2027)
RI1: Lending by commercial banks to the private sector as a share of total domestic banking sector assets. (Of which: Commercial Bank of Ethiopia's (CBE) lending to the private sector as a share of its total assets).	45% (CBE: 20%)	55% (CBE: 30%)
RI2: CBE's compliance with Basel Core Principles regulations relating to the independence, fitness, and propriety of supervisory board members.	Not compliant.	Fully compliant, and at least 30% of CBE board members are independent.
RI3: Compliance of NBE capital adequacy directives with Basel Core Principles.	NBE capital adequacy directives are not consistent with Basel Core Principles.	NBE capital adequacy directives are consistent with Basel Core Principles.
RI4: Total volume of agricultural exports (metric tons/year)	1.2 million	1.6 million
RI5: Annual Value Added Tax collection, % of GDP.	1.2%	2.4%
RI6: Share of the non-CSEs (common use supplies and equipment) that have become mandatory under the Green Public Procurement.	0% (2024)	25%
RI7: Percentage value of Federal public procurements being undertaken by Federal public bodies excluding enterprises through the e-GP and with full beneficial ownership details disclosed, by each of the bodies.	0% (2024)	80%
RI8: Percentage of Federal SOEs with assets greater than ETB 15 billion that have published annual audited financial statements compliant with International Financial Reporting Standards for each financial year since FY21.	0% (2024)	90%
RI9: Recovery of the power sector's operational costs and debt service.	18%	70%
RI10: Government contribution to the financing of rural and urban safety nets, % of GDP	Less than 0.1%	0.4%
RI11: Share of female beneficiaries benefitting from the livelihoods and jobs components of the urban and rural safety net programs.	43%	65%
RI12: Hectares of forest area managed by forest cooperatives that are eligible to receive revenues from the sale and transfer of emissions reductions.	2.5 million (2024)	4 million
RI13: Hectares of landholdings that are securely registered in operational National Rural Land Administration Information System.	13.5 million (2024)	23.5 million
RI14: Share of new public sector projects in the agriculture, manufacturing, mining, and transport sectors that consider and include specific mitigation measures to address environmental and social risks in accordance with the amended ESIA Proclamation.	0% (2024)	40%

IDA PROGRAM DOCUMENT FOR A PROPOSED GRANT AND A PROPOSED CREDIT TO THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

1. INTRODUCTION AND COUNTRY CONTEXT

1. **This proposed Development Policy Operation (DPO) is the first in a programmatic series of two operations to support the Government of Ethiopia's efforts to: (i) advance financial sector restructuring and trade liberalization, (ii) promote fiscal sustainability and transparency, and (iii) enhance social resilience and climate action.** It comprises an International Development Association (IDA) grant in the amount of SDR 760.3 million (US$1,000 million equivalent) and an IDA credit in the amount of SDR 380.2 million (US$500 million equivalent). The DPO series supports reforms that help to address market distortions and constraints undermining macroeconomic stability and inclusive private-sector-led growth. This DPO series is part of a broader stabilization program that includes a four-year International Monetary Fund (IMF) Extended Credit Facility (ECF) program and expected debt treatment from the G20 Common Framework. The stabilization program supports the liberalization of the foreign exchange (FX) market and complementary measures to reduce financial and fiscal risks, promote trade, mobilize revenues, and expand social safety nets to mitigate the effects of the adjustment on the poor. This DPO is aligned with a forthcoming World Bank Country Partnership Framework for Ethiopia (CPF, FY2025-30) and the 2024 Ethiopia Country Climate and Development Report (CCDR).

2. **Ethiopia's state-led growth model supported high growth and social improvements.** Between 2004-2018, Ethiopia was one of the world's fastest-growing economies (average real growth of 10 percent). The state-led model increased access to infrastructure, services, and supported better living standards. Notable outcomes include expanding proximate potable water access to 60 million more people, doubling electricity access, and a 64 percent increase in child vaccinations. Between 2004 and 2016, these advances helped reduce the national poverty rate from 39 to about 24 percent.[1]

3. **However, these achievements came at a high cost.** Expansive public investments were central to the state-led model and were facilitated by an overvalued exchange rate, financial repression, debt, and trade and other regulatory restrictions.[2] The model crowded out private investment, undermined external competitiveness, fueled inflation, and exhausted external and fiscal buffers. Between 2009 and 2019, Ethiopia's external public debt-to-GDP ratio nearly doubled to 28 percent of GDP, and Ethiopia engaged in a first public debt restructuring exercise in 2019 to ease growing debt pressures. Financial repression, monetary deficit financing, and directed lending to state-owned enterprises (SOEs) contributed to misallocations of investments, structurally high inflation, and growing financial stability risks. High growth did not translate into sufficient productivity growth and job creation to cater to nearly two million new job market entrants each year. The economy's structure is broadly unchanged since 2004, and 70 percent of people rely on agriculture for their livelihoods.

4. **Persistent shocks and inadequate policy responses slowed growth, increased poverty, and triggered a debt default in late 2023.** Amid growing external imbalances and rising public debt, Ethiopia was hit by several shocks beginning in 2020, including the COVID-19 pandemic, the Tigray conflict, and persistent droughts. The Tigray conflict displaced over 20 million people and destroyed essential infrastructure and health services, and reconstruction cost estimates are US$20 billion. The worst drought in 40 years that led to six continuous failed rainy seasons, fueled hunger and displacement; over 15 million people still require food aid added to further pressures on constrained fiscal resources. As a result of these challenges, growth slowed to 6.5 percent between 2020-2023, and the poverty rate (US$2.15/day using international poverty lines) is estimated to have risen to 34.6 percent in 2023 from 27

[1] World Bank. Ethiopia Poverty Assessment (2019).
[2] World Bank. Ethiopia Systematic Country Diagnostic Update (2024).

percent in 2015.[3] In 2021, Ethiopia requested debt treatment under the G20 Common Framework due to increasing external financing pressures and declining official assistance. To manage FX pressures, the government tightened already onerous current account and financial sector restrictions and increased mandatory FX surrender requirements to 80 percent. As the tax-to-GDP ratio fell (now below 7 percent), and amid declining external financing, the government cut spending and severely limited wage increases and social safety net payments despite persistent inflation of about 30 percent. With rising FX shortages, Ethiopia began accumulating bilateral debt arrears and missed a US$33 million Eurobond coupon payment in December 2023.

5. **Climate change and conflict amplify Ethiopia's challenges.** Ethiopia is highly vulnerable to climate change. Major hazards include droughts, floods, heat stress, and pest infestations. These are already contributing to humanitarian needs and internal displacement. Climate change is expected to impose large, spatially concentrated, and growing costs on people and infrastructure with average annual losses to GDP estimated to rise from 1- 1.5 percent this decade to 5 percent in the 2040s, and at the upper range of estimates, could push 3.7 million people more below the poverty line (CCDR, 2024). The largest losses stem from reductions in livestock yields and from heat stress on labor productivity, followed by impacts on roads and bridges and from inland flooding. Households in rural areas, the lowlands, and the agricultural sector will be increasingly vulnerable due to land degradation and deforestation and a shift of climate hotspots to lowlands. These hazards pose risks to this operation, given depleted macroeconomic and social resilience. However, sustained reforms, including those supported by this operation would help mitigate impacts and build climate resilience. Additional geo-physical risks include volcanic and seismic activity.

6. **The government has initiated a new phase of reforms to reduce macroeconomic imbalances and revive growth.** In the last 18 months, the government has reduced fuel subsidies, tightened monetary policy, partially eased FX surrender requirements, and continued SOE reforms to strengthen oversight and constrain their borrowing. In addition, a Capital Markets Authority, a new deposit insurance program, and a new digital ID system (*Fayda*) were established, and measures are being taken to deepen regional trade integration. The government has reiterated its commitment to liberalize key sectors of the economy (retail and wholesale). In response to climate change risks, Ethiopia committed to adaptation and mitigation by adopting a Long-Term Low Emissions Development Strategy (LT-LEDS) in 2023.

7. **Ethiopia's development agenda remains vast, and its transition will take time.** The investment environment requires substantial reform to increase private sector entry and competition. Trade barriers remain significant. Ethiopia's trade-to-GDP ratio is the world's second lowest. It is not yet a World Trade Organization (WTO) member. Limited fiscal space has sharply reduced social and capital spending in real terms, and human capital levels remain low. A child born today will be 38 percent as productive as if she could enjoy a complete education and total health. SOEs remain inefficient, requiring bailouts, while regulatory privileges and a large footprint constrain the private sector. Addressing these issues requires macroeconomic stability and complementary structural reforms.

8. **The DPO series supports the government in building foundations for more inclusive and sustainable growth.** Actions in Pillar 1 help advance financial sector restructuring and trade liberalization by: (i) enhancing the central bank's independence and oversight of the financial sector, (ii) supporting the restructuring and reform of the state-owned and systemic Commercial Bank of Ethiopia (CBE), and (iii) liberalizing cereal exports. Actions in Pillar 2 strengthen fiscal sustainability and transparency by: (i) removing exemptions and reducing the fragmentation of the value-added tax (VAT), (ii) mandating the usage of electronic public procurement, (iii) enhancing SOE transparency, and (iv) supporting multi-year electricity tariff reforms. Actions in Pillar 3 enhance social resilience and climate action by: (i) improving the coverage and adequacy of social safety nets, (ii) strengthening the legal frameworks for rural

[3] World Bank. Macro-Poverty Outlook, Spring 2024.

land tenure and forest management, and (iii) enhancing environmental and social risk regulations for public investment. The operation is fully aligned with the World Bank's corporate commitments. Seven of ten prior actions are expected to generate climate co-benefits. The program will also help reduce gender gaps and enable private capital mobilization.

9. **The operation complements macroeconomic and exchange rate reforms supported under the IMF ECF and parallel World Bank-financed operations to support capacity building and reform implementation.** The IMF ECF supports programmatic macroeconomic reforms including: (i) upfront liberalization of exchange rates and current account restrictions and phasing out of surrender requirements and financial repression, (ii) ending monetary financing, strengthening central bank independence, and operationalizing an interest-rate based monetary policy framework, (iii) a revenue-led fiscal consolidation to enable an increase in social and pro-poor expenditures, and (iv) SOE reforms. Parallel World Bank-financed operations and technical assistance include a US$70 million Governance Modernization Project (under preparation) and a US$700 million Financial Sector Strengthening Project (under preparation)[4] (see Annex 6). The DPO also aligns with longer-term programmatic donor support focused in particular on safety nets, revenue mobilization, and SOEs. Additional budget support from partners is expected to complement this DPO.

10. **There is a high risk that the Program Development Objectives will not be fully achieved.** Addressing Ethiopia's macroeconomic challenges will require sustained reforms over the medium term. Effective program implementation depends on a credible and market-reflective exchange rate, timely completion of debt negotiations with creditors, and bold measures to mitigate financial and fiscal risks from CBE and energy utilities. Administrative capacity constraints could challenge the government's ability to meet these challenges and sustain reform momentum. Finally, the reforms being pursued by the government and supported by the DPO series and IMF ECF challenge longstanding policies that carry an inherent risk of opposition from vested interests. Mitigation measures include the government's commitment to macroeconomic stabilization as demonstrated by frontloaded exchange rate reform, increased cost recovery in the energy sector, improvements in revenue mobilization, enhanced financial sector oversight, and the expansion of safety nets, all of which are supported by this DPO series and the IMF ECF. The government is committed to enabling more private sector participation, easing trade, pursuing prudent fiscal policies, restructuring the energy and banking sectors, and improving the effectiveness of social protection. The programmatic nature of the DPO provides an opportunity for the World Bank to adapt to uncertainties. However, even with these measures, experiences from other exchange rate adjustments suggest that residual risks remain high. Notably, the initial phase of such reforms is unpredictable and can generate further budgetary and external financing needs beyond those envisaged by the overall stabilization program.

Box 1: Ethiopia's external debt restructuring status under the G20 Common Framework

In February 2021, the government requested debt treatment under the Common Framework, and the Official Creditor Committee (OCC) was formed in September 2021. The request was to strengthen debt sustainability and improve the risk of debt distress rating to moderate by the end of the 2019 ECF-EFF arrangements, consistent with the Fund's exceptional access criteria. This requirement will remain under the newly requested Fund-supported program. Ten OCC meetings have already taken place since, with the last held on July 11 2024. The OCC has committed to finding an appropriate solution for Ethiopia's debt vulnerabilities.

[4] The Governance Modernization Project will support improvements in tax administration (especially for excises, VAT and customs revenue) through investments in digital systems, improved business processes and capacity building, and more efficient taxpayer services alongside technical assistance to rationalize tax holidays and reform other taxes. The Financial Sector Strengthening Project will support the implementation of key laws and directives supported by the DPO series and includes the opening of the banking sector to foreign investment, implementation of the Basel II/III Framework and governance reforms.

In November 2023, Ethiopia reached a standstill agreement with official creditors, which resulted in a suspension of around US$3.2 billion in debt service due in 2023 and 2024. The debt service suspension is retroactive to January 1, 2023, and therefore resolves US$1.2 billion of official arrears that had accumulated (US$1.1 billion to China) earlier in 2023. The agreement included a claw-back provision, allowing the OCC to restore the original debt service obligations if a staff-level agreement on a new IMF-supported program is not reached by the end of June 2024. Ethiopia defaulted on its Eurobond obligations by missing a coupon payment of US$33 million in December 2023. The government is in restructuring negotiations with bondholders.

2. MACROECONOMIC POLICY FRAMEWORK

11. **The adequacy of the macroeconomic policy framework for the purposes of development policy financing hinges on, inter alia, the upfront exchange rate liberalization, addressing the country's debt vulnerabilities through a debt treatment consistent with the Debt Sustainability Analysis, and the government commitment to reforms.** Ethiopia's current macroeconomic imbalances and vulnerabilities result from a distortionary policy framework. Prior to World Bank and IMF Board submission, the government implemented a range of credible and substantive macroeconomic and structural reforms[5] to address protracted external vulnerabilities and fundamental market distortions, and to support financial stability and private-sector-led growth. The government has been engaged in restructuring negotiations with representatives of holders of the Eurobond (for US$1 billion) and on July 11, 2024, obtained credible financial assurances on official bilateral debt treatment under the G20 Common Framework. As a pre-condition for the IMF Board approval of the ECF program, Ethiopia has liberalized its exchange rate system. Going forward, sustained implementation of reforms is necessary to end fiscal and state dominance, advance the next phase of energy and banking sector restructuring and governance reforms to reduce risks from quasi-fiscal deficits, phase out financial repression, deepen trade integration and mobilize domestic revenues needed to finance a more inclusive growth agenda. While there remain uncertainties around the exact timing of eventual debt treatment, these measures are expected to reduce debt sustainability risks to "moderate" by mid-2028.

2.1. RECENT ECONOMIC DEVELOPMENTS

12. **GDP growth, while still robust, has slowed markedly relative to the previous two decades.** The scaling back of debt-financed public and SOE investments and construction projects due to financing pressures, alongside worsening exchange rate over-valuation, deteriorating external competitiveness, persistent droughts in the lowlands, and conflict have slowed growth to about 6.5 percent since FY2020. Despite this, activity has remained supported by improvements in highland harvests due to better rains and reforms to improve cluster farming and land tenure increased agricultural output. Several years of expansions from Ethiopian Airlines and telecommunications services by state and private operators have driven robust service growth. Agriculture and services growth has helped offset slowing manufacturing exports (due to FX shortages and the loss of US trading preferences) and construction activity (due to fiscal compression and lower capital spending). The end of the Tigray conflict in late 2022 also allowed for economic activity and services to resume, driving a pick-up in GDP growth to 7.2 percent in FY2023.

13. **Inflation is easing after two years of double-digit price growth.** Headline inflation remained at about 30 percent for two years, peaking at 37.2 percent in May 2022. Drivers include an over 200 percent increase in fuel prices, the central bank's monetary financing of the budget, lower agricultural production of essential commodities due to the conflicts in Tigray and Amhara, and disruptions to supply chains from problems at the Djibouti port. Inflation has since moderated to 23.1 percent in April 2024 as monetary policy was tightened. The National Bank of Ethiopia (NBE) targeted a reduction in advances to the government to 0.3 percent of GDP from about 0.9 percent in

[5] These include, in particular, prior actions supported in this DPO operation and the IMF ECF.

2022/23. It imposed a 14 percent cap on the growth of commercial banks' outstanding loans.

14. **A sharp fall in pro-poor spending is contributing to worsening poverty**. Higher poverty reflects the impacts of various shocks and high inflation. Amid fiscal consolidation, government spending on pro-poor expenditures has dropped by 1.5 percent of GDP since FY2021 (Table 2). Urban and rural safety net programs cover 9.7 million people, but the purchasing power of already low benefits has been eroded by high inflation, especially for rural beneficiaries.

15. **A sharp decline in official FX inflows has led to acute shortages, resulting in missed Eurobond payments in 2023**. The current account deficit narrowed to 2.8 percent of GDP in FY2023 due to import suppression through restrictions, lower global commodity prices, and higher service exports (related to Ethiopian Airlines). Goods exports, mainly coffee and flowers, have fallen over the last decade to less than 2 percent of GDP in FY2024. Foreign direct investment (FDI) and remittances have also fallen amid FX restrictions, onerous surrender requirements, and financial repression, while the parallel market premium has exceeded 100 percent. Amid increasing external arrears (US$1.2 billion in September 2023), a temporary standstill agreement with G20 creditors, a US$2 billion loan deposit from the United Arab Emirates to the NBE (for FX reserve management), and a default on a Eurobond coupon payment in December 2023 provided temporary FX liquidity. However, external financing needs remain significant, and this temporary relief is insufficient to cover fuel, fertilizer, and other essential import needs during 2024.

Table 1: Selected Economic Indicators for Ethiopia

	2020/21	2021/22	2022/23	2023/24p	2024/25p	2025/26p	2026/27p
	Annual percentage change, unless otherwise indicated						
National Accounts							
GDP at constant prices	6.3	6.4	7.2	6.1	6.5	7.1	7.7
Sectoral contribution to growth							
Agriculture	1.8	2.0	2.0	1.9	1.9	1.9	1.8
Industry	2.1	1.4	2.0	1.3	1.5	2.0	2.0
Services	2.5	3.0	3.2	3.0	3.1	3.3	4.0
Inflation							
GDP deflator	21.8	34.7	32.9	26.8	25.7	16.1	12.2
Consumer prices (average)	20.2	33.9	32.5	27.0	29.9	16.2	12.2
Selected Monetary Accounts							
Banks' credit to the government	56.3	97.4	35.7	15.7	4.4	20.8	24.8
Banks' credit to private sector	33.8	22.8	33.8	14.1	25.0	30.0	40.0
Broad money (M2)	29.9	27.2	26.6	14.5	30.0	25.1	26.6
External Sector							
Exports fob	10.9	22.8	3.3	3.9	7.9	15.0	17.3
Imports cif	2.3	24.9	-1.4	1.9	8.7	5.9	10.6
	Percent of GDP, unless otherwise indicated						
Current account balance (inc. grants)	-2.8	-4.0	-2.8	-2.8	-4.4	-3.1	-2.5
Foreign direct investment	3.6	2.6	2.1	1.6	2.8	3.3	3.0
Debt							
Public debt (external and domestic)	56.1	49.0	40.0	34.3	44.2	40.0	37.0
External debt	29.0	24.0	17.9	15.2	28.9	27.1	24.8
Debt service	1.8	1.5	0.9	0.6	2.5	2.0	2.0
Fiscal Accounts							
Total revenue and grants	11.0	8.5	8.2	7.7	9.0	10.5	11.5
Total expenditure and net lending	13.8	12.7	10.8	9.4	11.5	12.5	13.5
Overall fiscal balance (with grants)	-2.8	-4.2	-2.6	-1.7	-2.4	-2.1	-2.0
Memorandum items							
GDP per capita (%)	3.5	3.7	4.5	3.4	3.8	4.4	5.0
Gross reserves (US$ million, EOP)	2,866	1,495	1,026	1,056	2,814	4,984	6,707
In months of next year's imports	1.5	0.8	0.5	0.5	1.3	2.0	2.4
Nominal GDP (billion, local currency)	4,341	6,158	8,722	11,687	15,844	19,839	24,155

Nominal GDP (million, US$)	111,260	126,773	163,698				

Sources: Ethiopian authorities, World Bank, and IMF.

16. **Non-performing loans of state-directed SOE lending are a systemic financial sector risk.** SOE loans are 60 percent of the assets of the CBE, Ethiopia's largest commercial bank. Most of these non-performing loans are to state-owned Ethiopian Electric Power (EEP). Government guarantees have not been honored, and CBE does not provide for losses from these loans. Although CBE is profitable and sufficiently capitalized from an accounting perspective, economic earnings and capital are much lower after provisioning for non-performing loans, with CBE has also accumulated substantial FX on-balance sheet and off-balance sheet exposures (the latter related to Letters of Credit (L/Cs) commitments to finance the procurement of fuel and fertilizer imports).

17. **Declining revenue and official development assistance (ODA) have severely compressed spending**. Taxes as a share of GDP fell below 7 percent in FY2024, continuing a decade-long erosion of the tax base due to policy distortions that limit the taxable base and allow for large tax expenditures, high informality, and inefficient tax administration. ODA to the government budget fell to 1 percent of GDP in FY2023 from 3.2 percent in FY2020. As a result, public spending has halved since the late 2000s to below 10 percent of GDP, driven by cuts to capital spending and federal transfers to regions (which are responsible for delivering essential health and education services). In FY2023, the general government deficit fell by 1.7 percentage points to 2.6 percent, while the primary deficit narrowed to 2.0 percent. Rules mandating commercial bank purchases of treasury bills and central bank monetary financing have largely financed this deficit. Public debt as a share of GDP fell in FY2023 to 40 percent due to fiscal tightening, borrowing constraints on SOEs, and high nominal GDP growth.

Table 2: Key Fiscal Indicators for Ethiopia (percent of GDP, fiscal year basis)

	2020/21	2021/22	2022/23	2023/24p	2024/25p	2025/26p	2026/27p
Total Revenue and Grants	**11.0**	**8.5**	**8.2**	**7.7**	**9.0**	**10.5**	**11.5**
Tax revenues	9.0	7.1	6.8	6.3	7.4	8.9	10.0
Direct taxes	4.0	3.4	3.0	3.1	2.8	3.7	4.1
Domestic indirect taxes	2.5	1.6	1.8	1.8	2.4	2.8	3.2
Import duties and taxes	2.5	2.1	1.9	1.5	2.2	2.4	2.7
Non-tax revenues	1.3	1.0	1.0	1.0	1.0	1.0	1.0
Grants	0.8	0.4	0.4	0.4	0.6	0.6	0.5
Expenditure	**13.8**	**12.7**	**10.8**	**9.4**	**11.5**	**12.5**	**13.5**
Current expenditure	8.4	8.4	6.7	5.7	7.8	7.9	8.2
Defense spending	0.9	1.7	0.9	0.4	0.5	0.6	0.6
Poverty-reducing expenditure[1/]	4.1	3.4	2.7	2.4	3.1	3.8	4.0
Interest payments	0.6	0.6	0.6	0.6	1.1	1.2	1.2
Domestic	0.4	0.4	0.5	0.5	0.9	1.0	1.0
External	0.2	0.2	0.1	0.1	0.2	0.2	0.2
Capital expenditures	5.4	4.3	4.1	3.7	3.7	4.7	5.3
Overall balance, including grants	**-2.8**	**-4.2**	**-2.6**	**-1.7**	**-2.4**	**-2.1**	**-2.0**
Primary balance	-2.2	-3.5	-2.0	-1.1	-1.3	-0.9	-0.8
Financing	**2.8**	**4.2**	**2.6**	**1.7**	**2.4**	**2.1**	**2.0**
Net external financing	0.7	0.1	0.3	0.2	1.6	0.1	0.2
Net domestic financing	2.1	4.1	2.3	1.5	0.8	1.5	1.8
Memorandum items:							
Official development assistance (ODA)	1.4	0.8	1.0	0.6	2.9	1.3	1.2

Sources: Ethiopian authorities, World Bank, and IMF. 1/ Includes health, education, agriculture, roads, and safety nets.

18. **Potentially significant fiscal risks from SOEs remain unaccounted for.** Despite reforms to harden SOE budget constraints and improve SOE oversight (including through support from the World Bank's Sustainable Development Policy Framework, SDFP), SOEs remain a significant source of fiscal risks. For example, below-cost

electricity tariffs have led to substantial quasi-fiscal deficits. The related suspension of loan payments to CBE has, in turn, contributed to financial stability risks. Public sector FX exposures are another source of unaccounted risks—especially the settlement of supplier credits and debts for already delivered fuel and fertilizer imports. Weak and non-transparent SOE financial reporting and governance practices prevent a complete understanding of these risks and their likelihood of materialization.

19. **The government has resumed reforms, but progress remains uneven.** To eliminate subsidies, retail fuel prices were raised by 250 percent since mid-2022 and are at full cost recovery at current official exchange rates. Hardened domestic borrowing constraints on SOEs aligned with SDFP commitments helped lower public debt. A new deposit insurance fund was operationalized in late 2023 to protect bank and micro-finance depositors. In 2023, the *Fayda* ID system was launched to increase access to biometric identification as a gateway to a range of public and private services. Progress in other areas has been slower, including a failure to attract bids for a third telecom license due to a challenging business environment. Measures to liberalize logistics have had mixed results, with no foreign companies bidding for multimodal licenses. Two of the three new private-sector licensees are companies owned by regional government endowment funds.

20. **In early 2024, the government announced a second phase of its Home-Grown Economic Reform Agenda (HGER 2.0).** The HGER 2.0 aims to revive Ethiopia's reform program after several years of shocks and setbacks from conflict and prioritizes macroeconomic stability, creating a conducive investment environment and boosting sectoral productivity. Reforms supported by the World Bank DPO and IMF ECF programs and identified by the HGER 2.0 are highlighted in Table 3.

21. **Ethiopia is in debt distress.** Public and publicly guaranteed debt as a share of GDP declined to 40.2 percent by June 2023 from 49 percent in the previous year. External debt as a share of GDP fell for the fifth year to 18.1 percent due to lower official bilateral borrowing (including a zero non-concessional borrowing limit under the SDFP), constraints on SOE borrowing, and high nominal GDP growth. Still, lower FX inflows, exports, and domestic revenues pushed Ethiopia into debt distress following the announcement of a standstill by Common Framework creditors and a missed Eurobond coupon payment at end-2023. Although domestic debt has fallen as a share of GDP, much of this debt stock is non-performing and contributes to the financial system's rising systemic risks. CBE holds nearly all SOE domestic debt, which is not performing.

Table 3: Key Reforms supported in World Bank DPO and IMF ECF

IMF ECF Supported Reforms	DPO Supported Reforms
• Exchange rate liberalization, easing of current account restrictions, phase-out of FX surrender requirements. • Strengthened NBE independence. • Shift to an interest-rate-based monetary policy framework. • Phase-out of financial repression mechanisms. • VAT, excise stamp, property, and direct tax reforms. • Reforms of state-owned enterprises.	• Strengthened legal framework for effective bank supervision by NBE. • Reform and recapitalization of CBE and banking sector liberalization. • Trade reforms, including lifting agricultural export bans, and alignment to Africa Continental Free Trade Area (AfCFTA) tariffs on goods, and regulatory standards. • Revenue mobilization reforms, including VAT, corporate taxes, presumptive income taxes, and property taxes. • E-procurement reforms and transparency of SOE accounts. • Energy tariff reform. • Safety net expansion and modernization. • Land-use and forestry reforms.

2.2. MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

22. **Successful exchange rate liberalization, structural reforms, and debt treatment would lift growth in the medium term.** Sustained reform implementation, supported by the DPO series and IMF ECF, is expected to lift potential growth to about 8 percent in the medium term. These include: (i) the shift to market exchange rates and

related improvements in external competitiveness, (ii) ending of financial repression, and more credible monetary, banking and fiscal frameworks that support macro-financial stability, (iii) the shift away from direct controls (e.g., on trade) and greater role of market forces to intermediate credit, and (iv) broader structural and institutional reforms. These reforms will encourage more productive activity, promote exports, incentivize private saving and investment, and lessen resource misallocations and transfer of resources from exporters, remittance earners, private firms and households to the public sector. Agriculture comprises a third of the economy, supporting livelihoods for 70 percent of the population, with rural land tenure reforms expected to support a consolidation of fragmented landholdings, and drive productivity enhancements and trade. The completion of major hydro-investments would provide a further boost to growth in the longer term, by increasing energy supply. In the near term, however, only a modest uptick in GDP growth is anticipated due to tight monetary policies, pent-up import demand in the private sector, import needs related to reconstruction, and potential investor uncertainty during the initial transition period. Coupled with a narrow export and private sector base, this is expected to dampen the economy's initial response to shifting relative prices and structural reforms, with GDP growth expected to rise to 6.5 percent in FY2025 from 6.1 percent in FY2024.

23. **The outlook for financial stability and intermediation depends on reforms to remove market distortions and modernize the central bank.** As part of the HGER and with support from the IMF ECF and World Bank DPO, the government will advance reforms to: (a) strengthen the central bank mandate and independence to promote financial stability; (b) restore CBE's capital adequacy and improve its liquidity through recapitalization equivalent to CBE's claims on non-performing SOE loans; and (c) open the banking sector to foreign investment as a way of increasing competition and faster regulatory convergence to international norms. The financial sector's stability is expected to improve as reforms are implemented, although potential downside risks for commercial banks that emerge from the macroeconomic adjustment will require careful monitoring. A new Ethiopian Securities Exchange in October 2024 will enable secondary debt and equity trading, while banking liberalization would encourage healthier financial intermediation.

24. **The current account is anticipated to remain in deficit but is expected to be sustainably financed**. The liberalization of the FX market and current account restrictions and phasing out of surrender requirements will help ease FX shortages (and in turn of raw-materials and imported inputs). Along with the easing of restrictions on trade and deeper regional integration and increasing regional energy exports as hydropower investments are completed, this will encourage exports and remittances (including flows routed through official channels) over the medium term.[6] Higher ODA disbursements and savings from eventual debt treatments will complement these inflows. Over time, higher FDI inflows will offset moderating ODA as privatization resumes (including selling a 40 percent stake in Ethio-Telecom in FY2025) and banking, wholesale, and retail trade is liberalized. Although FDI as a share of GDP doubles by FY2027, it is expected to remain below pre-conflict levels.

25. **Inflation is expected to moderate after an initial increase.** FX market and energy tariff reforms will likely increase inflation during FY2025, which is expected to peak at about 35-40 percent. Most imported goods are already priced at parallel market rates (except fuel, fertilizer, and some pharmaceutical imports). Price pressures will also be contained by a staggered increase in administered fuel and fertilizer prices (to reach parity with international prices following the FX reform[7]). Inflation is expected to moderate to low double-digits by FY2027 as FX availability and imported input shortages ease and as agricultural supply increases following years of drought.

26. **Higher tax collection will support fiscal consolidation**. Under the IMF ECF and World Bank DPO assumptions, revenues are expected to increase by 4.5 percentage points of GDP over four years. Initial reforms include the removal of numerous VAT exemptions (while maintaining the current 15 percent VAT rate), as well as

[6] Informal remittance inflows and underreported exports (using mirror trade data) are estimated to be at least US$4 billion per year.
[7] Current pump prices in Birr are already above cost recovery on the pre-reform exchange rate.

new property and excise taxes. In FY2025, VAT, excise, and property tax reforms are estimated to yield at least 0.3, 0.4, and 0.1 percent of GDP, respectively. By FY2027/28, these gains are expected to improve to 1.2, 0.7, and 0.3 percent of GDP, respectively. Reforms will also expand the tax base (by consolidating VAT and presumptive income taxes) and improve tax and customs administration. Planned reforms to rationalize income tax exemptions, curtail tax holidays, increase interest withholding rates, and expand property taxes are expected to yield an additional 2.5 percent of GDP in revenue by 2027/28. In addition to these increases, higher trade tax collections from exchange rate revaluations will contribute to higher tax collections.

27. **Revenue improvements will enable higher social expenditures needed to mitigate the impact of the adjustment on the poor.** The government has budgeted 1.5 percent of GDP to mitigate adverse poverty and social impacts in the first year of macroeconomic adjustment. The reforms supported by the DPO series will support a large and durable expansion in federal government contributions to the financing of safety nets from less than 0.1 to 0.4 percent of GDP, an inflation adjustment for beneficiaries, a temporary shock response measure to mitigate the impact of macroeconomic reforms and a structural increase in the number of beneficiaries. Under the IMF ECF program, 0.5 percent of GDP in budget spending supports a gradual phaseout of fuel and fertilizer subsidies over six months, with the government committing to eliminating fuel subsidies by early 2025 and reducing fertilizer subsidies to 0.3 percent of GDP by FY2026. Overall, pro-poor spending is expected to nearly double from 2½ to 4 percent of GDP. Interest costs associated with CBE recapitalization supported by this DPO are expected to cost 0.5 percent of GDP annually.

28. **Debt sustainability risks are expected to be moderate.** Anticipated debt treatment under the G20 Common Framework (and complementary treatments reached with private creditors), higher medium-term exports, and IMF ECF/World Bank DPO program support will contribute to the moderation of debt sustainability risks. Following a rise due to valuation changes following exchange rate liberalization, public and publicly guaranteed (PPG) external debt is expected to decline to 24 percent of GDP over the projection period. The Debt Sustainability Analysis (DSA) highlights the sensitivity of the debt trajectory to future GDP, exports, and exchange rate shocks. Under the baseline, without debt treatment, public debt is unsustainable. However, under program and debt treatment assumptions and contingent on the government's full implementation of macroeconomic and structural reforms, PPG debt is assessed to be sustainable on a forward-looking basis. Debt sustainability risks are expected to shift from high to moderate by 2028 due to increased exports, increasing Ethiopia's resilience to extreme shocks, and higher reserve cover supporting a higher debt-carrying capacity (Figure 1).

29. **Downside risks to these macroeconomic projections are high.** First, the intensification of conflict could undermine private investment, growth, and macroeconomic stabilization efforts. Second, external or fiscal financing pressures could arise from lower-than-expected ODA, FDI, remittance inflows, or adverse global commodity price dynamics. Third, significant risks are posed by the unaccounted fiscal risks and FX exposures, the magnitude of which may be highly sensitive to currency dynamics. In the banking sector, these risks arise from the sovereign-bank nexus (due to past financial repression) and substantial FX net open positions. In the energy sector, these relate to L/C obligations for fuel and fertilizer imports and the financial health of the energy utilities. Furthermore, the expected revenue adjustment may disappoint due to weaknesses in tax administration. Given that World Bank and IMF financing is frontloaded, it may be difficult to mobilize additional resources to mitigate these risks later in the program. Should these risks materialize, they may require unplanned fiscal and balance of payments adjustments. The rising costs of addressing these challenges will also prolong financial repression and crowd out private sector financial access. Unexpected public sector FX needs could derail FX market reforms and worsen balance of payments pressures. To partially mitigate these risks, the government is: (i) frontloading key macroeconomic reforms, (ii) prioritizing socially protective and pro-poor spending as a buffer against price and adjustment shocks, (iii) requesting debt relief under the G20 Common Framework, and (iv) working with the World Bank and other development

partners on complementary operational engagements in the financial sector and tax reforms.

30. **The macroeconomic policy framework is considered adequate for development policy financing in the expectation of the successful execution of a debt restructuring in line with the DSA**. This is supported by the government's credible commitment to reforms to strengthen the macroeconomic framework and support more sustainable and inclusive growth (as supported by actions across the pillars of this DPO series and the IMF ECF). Following the receipt of credible assurances for timely debt relief by the G20 Creditors Committee, the IMF ECF has been submitted to its Board for consideration on July 29, 2024. The DPO approval is predicated on having the IMF ECF program approval and first disbursement of its expected financial support. The anticipated US$3.5 billion in reduced debt service as part of G20 debt treatment is expected to lower the debt risk assessment to "moderate" by 2028. At the same time, the balance of payments is projected to remain sustainable, supported by a gradual improvement in exports, FDI and capital inflows.

Table 4. Public and Publicly Guaranteed Debt Stock and Debt Service

	Debt stock (end of period)			Debt service			
	2022/23			2023/24	2024/25	2023/24	2024/25
	US$ million	Percent of Total	Percent of GDP	US$ million		Percent of GDP	
Total PPG Debt	**64,274**	**100.0**	**40.2**	**8,211**	**7,502**	**3.9**	**5.5**
Domestic Debt	**35,344**	**55.0**	**22.1**	**7,291**	**4,944**	**3.5**	**3.6**
Treasury bills	6,262	9.7	3.9	-	-	-	-
Bonds	12,453	19.4	7.8	-	-	-	-
Others	16,629	25.9	10.4	-	-	-	-
External Debt	**28,606**	**45.0**	**18.1**	**920**	**2,557**	**0.4**	**1.2**
Multilateral creditors	15,269	23.8	9.6	650	694	0.3	0.3
Bilateral Creditors	12,108	19.3	7.8	115	761	0.0	0.4
Paris Club	1,772	2.9	1.2	21	109	0.0	0.1
Non-Paris Club	10,336	16.4	6.2	94	653	0.0	0.3
Commercial Creditors	1,229	1.9	0.7	155	1,134	0.1	0.5
Memo items							
SOE guaranteed external debt	*6,299*						
LCU per USD: Official (EOP)	*54.59*						

Sources: Ethiopian Authorities, World Bank and IMF

Figure 1a: PV of external PPG debt-to-GDP ratio

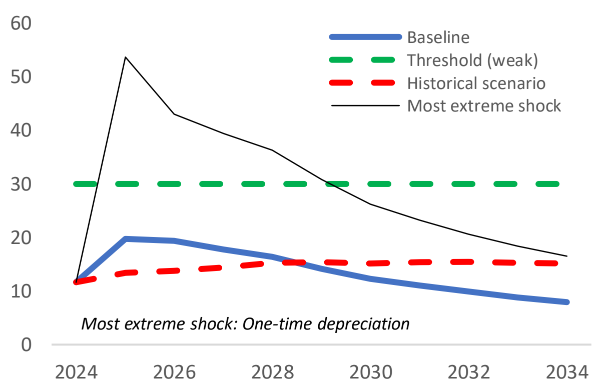


Figure 1b: PV of external PPG debt-to-exports ratio

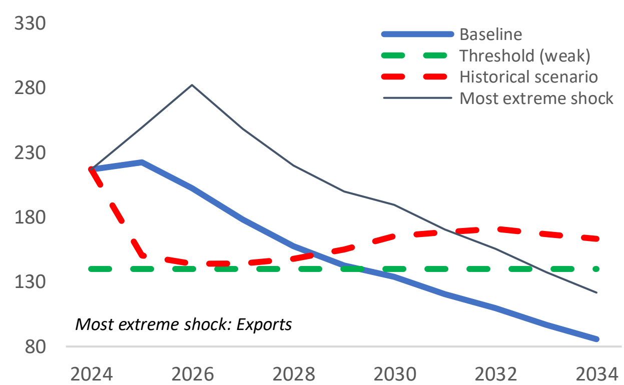


Figure 1c: External debt service -to-exports ratio

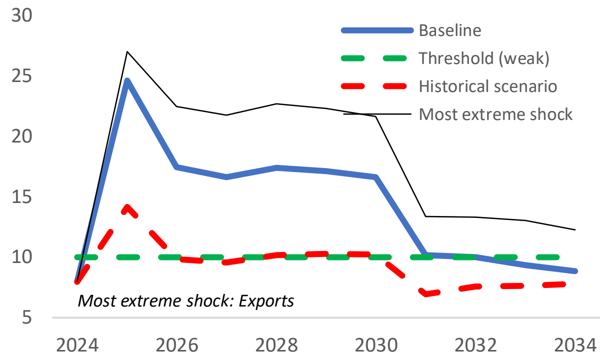
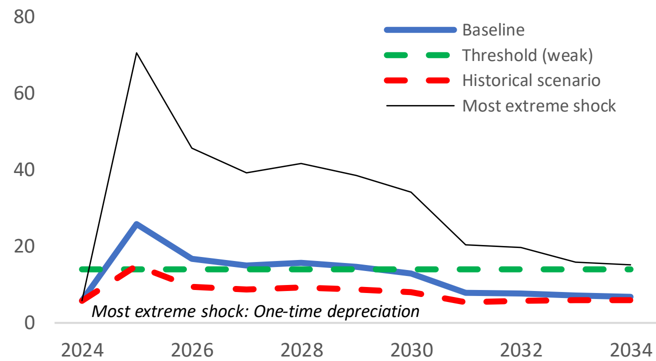


Figure 1d: External debt service -to-revenue ratio



31. Source: World Bank and IMF based on DSA findings (2024).

Table 5: External Financing Needs and Sources

	2021/22	2022/23	2023/24p	2024/25p	2025/26p	2026/27p	2027/28p
Financing Requirements	**7,374**	**8,048**	**8,549**	**9,878**	**6,992**	**6,209**	**5,813**
Current account deficit	5,134	4,635	5,896	6,015	4,577	4,050	3,565
Long-term debt amortization	2,302	1,830	2,081	3,263	2,415	2,159	2,248
Federal government	343	429	685	1,718	890	920	1,082
Other public sector	1,959	1,401	1,396	1,545	1,526	1,239	1,165
Short-term debt amortization							
Other capital outflows (incl. deposits)	-62	1,583	572	600	0	0	0
Available Financing	**7,374**	**8,048**	**8,549**	**9,877**	**6,993**	**6,207**	**5,813**
Foreign direct investment (net)	3,308	3,428	3,333	3,775	4,812	4,853	5,621
Portfolio investment (net)							
Capital grants							
Short-term debt disbursements							
Long-term debt disbursements (excl. IMF)	907	2,913	3,626	4,269	3,130	2,551	2,530
Federal government	616	2,372	1,090	3,355	2,830	2,232	1,985
Other public sector	291	541	2,536	914	300	319	545
IMF credit (net)	397	0	-212	1,647	455	455	438
Change in reserves (- = increase)	1,919	378	-30	-1,757	-2,170	-1,723	-3,035
Debt suspension and restructuring	720	475	1,832	1,943	766	71	259
Errors & Omissions	123	854					

Sources: Ethiopian Authorities, World Bank, and IMF.

2.3. IMF RELATIONS

32. **The government of Ethiopia has requested a four-year ECF arrangement to support their economic program that includes prerequisites for this DPO.** The ECF arrangement would be for SDR 2,555.95 million (US$3.4 billion) and provide about US$1 billion in disbursements upon IMF Board approval. IMF and World Bank financing, other partner financing, and debt treatment will help close a balance of payments financing gap of about US$10.4 billion (Table 5). The ECF focuses on transitioning to market-determined exchange rates, shifting to positive real interest rates and interest-based monetary policy, mobilizing more revenues, increasing social expenditures, restoring debt sustainability, and reforming SOEs. The IMF ECF program has been submitted to its Board. As a pre-condition for the IMF Board approval and first disbursement of the ECF program, Ethiopia has liberalized its exchange rate system. The World Bank and IMF have collaborated closely on their programs. Reforms supported by the IMF ECF and the World Bank DPO series strongly complement each other.

3. GOVERNMENT PROGRAM

33. **The HGER guides government reform priorities**. The HGER 2.0 focuses on restoring macroeconomic stability and supporting private-sector-led growth through reforms in trade, finance, energy, and agriculture, among other sectoral reforms. Higher agricultural productivity and food security are the emphasis of a 10-year Master Plan for the Agriculture Sector (2020–30) and an Agriculture and Rural Development Policy. A National Energy Policy and Energy Efficiency Strategy aims to achieve universal electricity coverage by 2030, boost energy exports, and restore the sector's financial health.

34. **The Government has long prioritized climate action for sustainable, green growth**. Adaptation and mitigation goals were first articulated in the 2011 Climate Resilient Green Economy strategy, which identified agriculture, deforestation, energy, and transport as climate action priorities. The updated Nationally Determined Contribution in 2021 and the 2023 LT-LEDS further reaffirmed Ethiopia's commitment to adaptation and ambitious mitigation targets. A Green Legacy Initiative launched in 2019 aims to restore degraded lands and increase forest cover.

4. PROPOSED OPERATION

4.1. LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

35. **The program development objective (PDO) of the DPO series is to support the Government of Ethiopia's efforts to: (i) advance financial sector restructuring and trade liberalization, (ii) promote fiscal sustainability and transparency, and (iii) enhance social resilience and climate action.** Pillar 1 actions would increase financial intermediation and liberalize trade by strengthening central bank independence and the legal framework for banking supervision, supporting the restructuring of the CBE, increasing foreign investment and competition in the banking sector, and expanding trade opportunities. Pillar 2 actions would mobilize tax revenues, expand e-procurement, improve cost recovery in the electricity sector, and enhance public sector financial transparency. Pillar 3 actions would cushion the poor from the impact of macroeconomic reforms by expanding and improving social safety nets, enhancing land tenure and forest management, and incorporating climate considerations in public investment, all of which will help build resilience and generate climate co-benefits.

36. **This DPO builds on lessons from the Implementation and Completion Results (ICR) report of the 2019-2020 Ethiopia Growth and Competitiveness DPO series.** The ICR highlighted the importance of addressing market distortions, especially the overvalued exchange rate, as central to the success of broader structural reforms. Although FX market reforms are not a prior action of this operation, they are a pre-condition for the World Bank's Board approval of the DPO. Second, the ICR noted the importance of significant contextual risks and incorporating strong mitigation measures. The DPO series includes measures to help reinforce the FX reforms through complementary policy reforms (e.g., manage banking stability risks and electricity tariffs adjustments), social measures (e.g., safety net expansions, raising of thresholds on personal income taxes, VAT reform that allows exemptions for basic foodgrains, bread and agricultural inputs such as fertilizer) to protect the poor, and other structural reforms (e.g., rural land reforms, lifting of cereal export bans) to help increase rural incomes and maintain popular support for macroeconomic adjustment. Third, the ICR notes the importance of strong analytical groundwork, and complementary operational engagements given significantly weak institutional capacity. This DPO series is complemented by parallel governance, finance, energy, and social protection operations to ensure deeper, sustained engagements in critical policy areas. Tax reforms, e-procurement and e-payment of rural safety net benefits respond to the World Bank Group's FCV Strategy recommendations to prioritize domestic resource mobilization and delivery

systems to finance core state functions, build trust and aid the transition out of fragility.

37. **The DPO series is aligned with the goals of the Paris Agreement.** The DPO-supported reform program is consistent with Ethiopia's updated Nationally Determined Contributions (NDCs), LT-LEDS, and CRGE commitments. Also, it aligns with CCDR recommendations to enable markets to work for a more carbon-efficient and climate-resilient economy. Although the operation does not directly support emission-intensive activities, banking and trade reforms that expand private investment and trade may increase greenhouse gas (GHG) emissions. The operation is expected to reduce GHG emissions through: (i) more sustainable land and forest management (which generate 90 percent of Ethiopia's carbon emissions); and (ii) energy sector financial sustainability that will reduce wasteful consumption, sustain Ethiopia's low-carbon energy generation investment strategy, and enable faster access expansions to renewable-sourced grid and off-grid electricity that reduce energy emissions from carbon-emitting alternative energy sources (wood, charcoal, diesel). It will contribute to climate change priorities through safety net expansions, where 77 percent of all beneficiaries participate in public works programs directly linked to climate adaptation priorities. Other prior actions are not likely to increase Ethiopia's GHG emissions or restrict low-carbon development. Climate events, especially droughts, could affect the achievement of the PDO by reducing growth and increasing external financing needs. However, several prior actions (trade, safety nets, land reforms, green procurement, and ESIA) could reduce climate risks. Prior actions that do not contribute directly to adaptation but are not at risk from climate hazards include measures concerning the financial sector, energy tariffs, tax reform, and fiscal transparency. All prior actions are aligned with the mitigation, adaptation, and resilience goals of the Paris Agreement. Annex 5 provides a detailed review.

4.2. PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

Pillar 1: Advance financial sector restructuring and trade liberalization

38. **Reforms in this pillar aim to improve the intermediation of finance and trade by:** (i) strengthening NBE's independence to increase financial sector stability and the soundness of the banking sector, (ii) reforming and restructuring CBE to allow for the sustainable and viable recapitalization of a bank that is commercially oriented and focused on private sector lending, and (iii) lifting export trading restrictions on maize and barley to increase market access for small farmers, alongside reforms to prepare for regional trade integration.

Prior Action 1: To strengthen the central bank's oversight of the banking sector, the Council of Ministers (COM) has submitted to Parliament amendments to the Establishment Proclamation for the National Bank of Ethiopia enhancing the independence of the NBE and its mandate to promote financial stability.

39. **Rationale**: Financial stability risks accumulated at CBE and in other private banks can only be addressed with an independent central bank with the mandate, powers, and policy tools to promote financial stability underpinned by a more robust legal and regulatory framework. In Ethiopia, in addition to monetary financing of deficits, weak central bank independence and autonomy are reflected in the weak supervision of the banking sector. Current NBE directives also distort financial intermediation by requiring commercial banks to purchase Development Bank of Ethiopia (DBE) bonds equal to 1 percent of their annual lending and buy five-year government bonds at a fixed (negative real) interest rate. The NBE also directs the CBE to open L/Cs with foreign creditors on behalf of the public sector and to service them from the CBE's own FX resources. This undermines CBE's stability and NBE's enforcement of prudential net open position (NOP) limits.

40. **Substance**. A new NBE Establishment Proclamation would help overhaul Ethiopia's central banking legal framework and enhance the operational independence of the NBE to pursue the government's monetary policy objectives, with the IMF ECF supporting Ethiopia's transition to interest-based monetary policy. The amended law further establishes NBE as an independent supervisor with a clear mandate to promote financial stability. It would

also strengthen NBE's powers and accountabilities relating to banking supervision through greater alignment with core principles established by the Basel Committee on Banking Supervision. The Proclamation, which is a key reform priority in the IMF ECF, will also require the NBE Board's composition to meet more robust standards for directorial fitness, propriety, and independence from political and corporate influence.

Prior Action 2: To strengthen financial stability and intermediation, (a) the COM has submitted to Parliament the draft Banking Business Proclamation; (b) the NBE has issued five directives that strengthen regulations for (i) asset classification and provisioning; (ii) related party transactions; (iii) large exposures; (iv) fit and proper requirements for bank boards; and (v) corporate governance and (c) the COM has adopted a Reform, Restructuring and Recapitalization Plan for Commercial Bank of Ethiopia (CBE).

Indicative Trigger 1: To strengthen financial stability and improve competition in the banking sector, the Recipient has: (a) enacted the NBE Establishment Proclamation and the Banking Business Proclamation; and (b) through the NBE, has issued Directives: (i) operationalizing key elements of the bank resolution framework; (ii) prohibiting the issuance of letters of credit without adequate foreign exchange coverage; (iii) enhancing risk management of net open positions, related party transactions, and large exposures; and (iv) allowing foreign investment in the banking sector.

41. **Rationale**: CBE, Ethiopia's largest bank (58 percent of banking sector assets), is undercapitalized because of non-performing loans issued to SOEs.[8] This poses significant financial stability risks and undermines healthy financial intermediation. Addressing this requires more robust regulatory measures that address the underlying sources of these risks and create conditions for institutional improvements to financial accounting, risk management, and corporate governance practices in CBE and the wider banking sector. Although these measures are a prerequisite, the broader structural objective of enhancing the quality of financial intermediation also requires reforms to expand competition and private investment in the banking sector, including foreign investors.

42. Fundamental changes are required to CBE's operating model**.** These include changes to its balance sheet, business model, governance, and risk management framework to: (i) adjust to forthcoming FX and monetary policy reforms, (ii) improve financial health over the medium term, and (iii) enable more productive financial intermediation to private firms. CBE lacks a commercial mandate and has functioned as a policy bank to channel credit to unviable SOEs, crowding out credit to more productive private firms. Its credit risk pricing, classification, and provisioning practices need considerable strengthening. Once losses and non-performing loans are fully accounted for, CBE needs to be recapitalized to reach the required minimum of 8 percent capital adequacy ratio (CAR). The elimination of FX surrender requirements to support forming a market-reflective exchange rate will also require CBE to compete more actively for FX from FX depositors and interbank markets.

43. **Substance**: The Banking Business Proclamation provides the legal basis to open foreign participation (and competition) in the banking sector, transition to Basel II/III standards, and introduce a new resolution framework for banks. The directives: (i) bring assets classification and provisioning in line with international prudential and accounting standards and enable CBE to re-classify exposures towards SOEs (including EEP) as non-performing despite the government guarantee (and write these off) and strengthen policies to prevent multiple loan forbearance and evergreening; and (ii) require adequately pricing of and constraining credit exposure to related parties, including limiting exposure to a single SOE and all SOEs, respectively to 15 and 35 percent of the bank's capital. These are anchored by complementary directives on: (i) fit and proper requirements for bank boards to enhance requirements

[8] The Development Bank of Ethiopia (DBE), the other state-owned bank, does not pose a significant risk to financial sector stability as it is not deposit-taking and its relative size is small (6 percent of banking sector assets). Its asset quality has shown significant improvement over time.

concerning integrity, experience, time commitments, and conflicts of interest, (ii) large exposures to limit the maximum loss a bank could face from the default of a single counterparty or a group of connected counterparties; and (iii) corporate governance, by introducing independent directors, and enhance the accountability regime of board and senior management.

44. Key milestones in the CBE Reform, Restructuring, and Recapitalization Plan include arms-length governance arrangements supported through clarification of the CBE ownership policy by its owner (Ministry of Finance), defining a clear commercial mandate and appointment of independent board members by the state holding agency (EIH), and adoption of a credible Business Action Plan by CBE to strengthen its corporate governance. Restructuring CBE's balance sheet entails absorbing credit losses upfront, addressing FX exposures, and shrinking the balance sheet to reduce the too-big-to-fail dilemma. It is also an essential prerequisite for World Bank-financed project support and eventual privatization. Recapitalizing the CBE will be based on the success of the reform and restructuring parts of the plan.

45. **Indicative trigger**. The DPO-2 indicative trigger will strengthen financial stability by operationalizing a bank resolution framework and strengthening FX risk management measures concerning letters of credit and SOE operations. The DPO-2 will continue to focus on CBE. The new Banking Business Proclamation provides the legal basis for foreign investments in the banking sector. The DPO-2 will support new directives that operationalize this provision to enable foreign entry. This will increase competition, modernization, and innovation in the financial sector, expand financial access, and incentivize faster regulatory convergence to global standards.

46. **Expected results:** Improved financial stability, increased competition, and subsequently healthier financial intermediation by CBE are measured by an anticipated increase in lending by commercial banks to the private sector (as a share of total domestic banking sector assets) from 45 percent in 2023 to 55 percent in 2027 for the banking sector, and 20 to 30 percent for CBE, specifically. In addition, results indicators capture: (a) improved CBE's compliance with Basel Core Principles concerning fitness, propriety, and independence criteria for CBE supervisory board members, and (b) compliance of NBE capital adequacy directives with Basel Core Principles.

Prior Action 3: To support agricultural exports, the Ministry of Trade and Regional Integration, has: (a) issued two directives lifting export bans on maize and sorghum, and on barley; and (b) submitted a tariff offer to the AfCFTA aligning tariffs on trade in goods to AfCFTA standards.

Indicative Trigger 2: To promote trade, the Recipient has: (a) implemented the tariff offer to the AfCFTA aligning tariffs on trade in goods to AfCFTA standards; and (b) adopted AfCFTA protocols on digital trade, investment, and competition policy.

47. **Rationale.** Trade (goods and services) in Ethiopia amounted to 20 percent of GDP in 2023, the second lowest in the world after Sudan, while goods exports are below 2 percent of GDP, exacerbating balance of payments and debt pressures.[9] Ethiopia has not yet joined the WTO, and the trade regime is highly restrictive. In 2021, the simple average MFN[10] tariff was 17 percent, as compared to 12.7 percent average for East Africa Community peers and 4.3 percent globally. Separately, Ethiopia has long maintained de-facto export restrictions on various grains, which are applied with little predictability and transparency. These have neither stabilized domestic prices nor ensured food security but have increased costs for farmers by disincentivizing value addition despite rising domestic yields and high regional and global demand for cereals in recent years. Implementing the African Continental Free Trade Area

[9] World Bank World Development Indicators (2022)
[10] Most Favored Nation

ratified in 2021 would help deepen rules and institutions to facilitate trade.

48. **Substance.** The lifting of the export ban for barley and maize addresses a significant barrier to agri-food trade, supports integration into global agricultural value chains, and creates income opportunities for rural households/small farmers by allowing them to export their surplus. A National Food Reserve Agency, responsible for maintaining strategic grain reserves, alleviates concerns about food security during times of scarcity. Efforts are also being made to introduce modern technologies for grain storage (e.g., improved silo systems), to reduce post-harvest losses and enhance storage efficiency. In November 2023, Ethiopia submitted a goods offer to the AfCFTA that the African Union Secretariat accepted in March 2024. Covering 6,476 goods and aiming to reduce tariffs to 1.3 percent over ten years, this is an important step to advance tariff-free trade with AfCFTA members and will support eventual accession to the WTO, for which negotiations are ongoing.

49. **Indicative trigger.** Implementing the goods tariff offer requires adoption by the Council of Ministers for subsequent ratification by Parliament. In addition to lower tariff rates, enhancing exports and investments requires measures to align with international/regional trade standards to support a more predictable, transparent trade regime. The indicative trigger on competition protocols will align regulatory standards with an integrated and unified African competition regulation regime and, through their implementation, will prevent gains from trade liberalization from being undermined by anti-competitive practices. Digital protocols will harmonize regulatory standards on data protection and governance, cross-border data exchanges, online consumer protection, cybersecurity, and emerging technologies. The investment protocol will strengthen investment protection standards, sustainable development-related issues, investor obligations, and management and settlement of disputes.

50. Expected results and climate benefits. Increased trade is measured by a 33 percent rise in annual agricultural export volumes from 1.2 million tons in 2023 to 1.6 million tons by 2027. Supported reforms will increase resilience to climate shocks (e.g., droughts) by reducing trade barriers to market access for food commodities. The tariff offer includes lower import tariffs on goods contributing to climate change risk mitigation (e.g., clean and renewable energy infrastructure such as solar equipment,[11] more energy efficient transport vehicles,[12] lighting and appliances[13]) and adaptation (e.g., more drought-resistant seed varieties and irrigation components). The lifting of maize and barley export bans incentivizes productivity-enhancing investments by small farmers that increase food surpluses that can be drawn on during droughts.

Pillar 2: Promote fiscal sustainability and transparency.

51. **Pillar 2 promotes fiscal sustainability** through tax, procurement, and energy sector reforms. Improved financial sustainability in the energy sector is also necessary for Pillar 1 reforms concerning CBE's financial health, as most of CBE's non-performing loans are from energy SOEs. Fiscal transparency is supported through mandatory e-procurement, free access to procurement opportunities and contract awards, and increased access to budgetary information for SOE and government financial accounts. Green public procurement is a critical measure supporting climate action.

[11] Diesel powered generators are widely used by households and farmers during prolonged power outages.

[12] Ethiopia's vehicle fleet is significantly older than in neighboring countries (about 20 years compared to 13 in Kenya and Uganda). The government has maintained very high taxes (including import tariffs) on the import of secondhand vehicles and has recently banned the import of fuel powered transport vehicles. However, these very high tariffs and duties are one factor that have contributed to thriving illegal cross-border trade.

[13] 40 percent and 14 percent of electricity consumption by (mostly higher-income) households is on lighting and refrigeration, respectively, with energy demand set to grow substantially as the middle class expands. (2023 Review of Ethiopian Energy Efficiency Policy, Danish Energy Agency).

Prior Action 4: To increase revenues from the value-added tax (VAT), the COM has submitted to Parliament amendments to the VAT Proclamation that: (a) reduce the number of items exempted for VAT; (b) limit the zero-rating for VAT purposes to only exported and re-exported items; (c) permit voluntary VAT registration by currently exempted businesses; and (d) grants exclusive authority to the Federal Government to collect the VAT.

Indicative Trigger 3: To improve the efficiency and equity of tax collection, the Recipient has: (a) enacted the VAT Proclamation and issued implementing regulations for the VAT Proclamation; (b) consolidated presumptive income tax rates; (c) raised thresholds for the personal income tax; (d) rationalized tax holidays; (e) introduced advance payments for the corporate income tax; (f) enacted the Property Tax Proclamation enabling Regional Governments to collect property taxes.

52. **Rationale.** Ethiopia's tax-to-GDP ratio has fallen to 6.7 percent. Domestic revenues are insufficient to finance social and development expenditures and ensure fiscal sustainability. Inefficient tax policy and weak tax administration contribute to this poor performance. The effectiveness of the VAT regime has been undermined by numerous exemptions and zero-rating that have eroded the tax base and led to a revenue leakage estimated at 2.4 percent of GDP (IMF 2020). Significant compliance gaps exist due to the fragmentation of responsibilities for VAT collection at the federal and regional levels and complex VAT registration, assessment, and refund processes.

53. **Substance.** The revised VAT legal framework maintains the uniform 15 percent rate. It reduces exemptions from more than 120 to 18.[14] It eliminates the zero-rating of all domestic items, limiting this to exports/re-exports. It increases the threshold for VAT registration from ETB 1 million to ETB 2 million to relieve SMEs from VAT obligations. Still, it allows voluntary registrations, addressing a key complaint from SMEs seeking to supply VAT-registered businesses (thus enabling an expansion of the tax base). It also introduces service standards such as a 30-day turnaround time for VAT refunds with penalty interest payments for delays (thus incentivizing the government). It eliminates a key source of VAT evasion by replacing the existing entity-based fragmentation of power across federal and regional governments with a dual VAT regime based on concurrent jurisdiction to levy VAT across levels of government. The reform is expected to generate at least 1-1.2 percent of GDP in additional revenues over the medium term and offers climate co-benefits (Annex 5).

54. **Indicative trigger.** In addition to the need to mobilize revenues to mitigate fiscal pressures, efforts are also needed to improve the equity and efficiency of the tax system. Exemption thresholds for the personal income tax regime, set in 2016, are below the poverty line, forcing the poor to pay income taxes. The absence of advance/installment payments in the existing Corporate Income tax (CIT) regime has contributed to non-compliance and reduced reliable cash flows to the Treasury. Extensive CIT tax holidays have led to sizable revenue losses, estimated at 0.6 percent of GDP (IMF 2020). The presumptive tax regime on small firms is fragmented, with thousands of rates resulting in compliance difficulties and encouraging informality. Reforms supported by the DPO-2 will: (i) introduce implementing regulations to support the implementation of the newly enacted VAT law; (ii) facilitate compliance by introducing a simplified turnover-based tax regime for all SMEs (with turnovers below the mandatory VAT threshold of ETB 2 million); (iii) initiate a CIT reform by laying out a time-bound roadmap for phasing out CIT tax holidays and making the payment of advance taxes during the accounting year mandatory; and (iv) provide enabling legislation to introduce an annual, recurrent property tax regime across the country with taxing powers to regions, which is expected to become a key source of own-source revenues for lower tiers of government.

55. **Expected results.** Annual VAT revenues are expected to double as a share of GDP to 2.4 percent by 2027.

[14] Exemptions removed cover transport, telecom, e-commerce and financial services, and water and electricity (with allowances for the poor).

Expanded tax base and reduced tax expenditures will support higher and more sustainable domestic financing for development.

Prior Action 5: To support more efficient, transparent, and sustainable procurement, the Recipient's Parliament has approved the Federal Public Procurement and Property Administration Proclamation mandating the use of e-procurement and the incorporation of green procurement principles.

Indicative Trigger 4: To strengthen public procurement, the Recipient has: (a) amended the Federal Public Procurement and Property Administration Proclamation to: (i) expand its applicability to public bodies, including federal public entities; and (ii) mandate the disclosure of beneficial ownership; (b) mandated the Federal Public Procurement and Property Authority to conduct performance audits; and (c) mandated the use of the e-GP system for all public entities.

56. **Rationale:** Public procurement amounts to 70 percent of spending by federal public entities (US$10 billion a year), with significant opportunities to strengthen efficiency, transparency, and integrity and to support climate action by the public and private sectors. Critical challenges identified in the Ethiopia 2021 MAPS Assessment include a fragmented legal/regulatory framework, the exclusion of SOEs from coverage, insufficient disclosure, overlapping functions and duties of regulatory bodies, and generally weak accountability, integrity, and transparency. A new e-government procurement (e-GP) platform brings substantial benefits but is used by only 40 percent of federal public entities. Other challenges include the irregularity of procurement audits and weaknesses in complaint mechanisms.[15]

57. **Substance**: The new law enshrines applicability to all federal public bodies and defines value for money from public procurement. It also clearly defines competitive bidding, transparency, fairness, and accountability concepts. The new law also helps embed climate considerations into public procurement to make it more environmentally friendly and sustainable and is broadly aligned with global standards.[16] It enables the deployment of e-GP across the public sector. Mandating full transparency and free access to procurement opportunities and contract awards on the e-GP platform will improve public procurement governance and increase trust in the system. Bringing more private sector players into the market will contribute to growth and job creation. The new law establishes a new administrative Complaint Review Board—a quasi-judicial semi-independent body accountable to the Ministry of Finance (MoF), comprising members from the Ministry of Justice, business/professional associations, civil associations, and relevant public boards. The law introduces life cycle cost principles in contract management to incentivize green procurement. In addition, the Federal Public Procurement and Property Authority (FPPA) is developing a strategic roadmap and methodology for its implementation based on the law's provisions.

58. **Indicative trigger**: The law needs further amendments to ensure its applicability to SOEs and to strengthen beneficial ownership disclosure requirements and complaint mechanisms. Directives mandating e-procurement and compliance and performance audits by the regulatory authority will support the law's operationalization.

59. **Expected results and climate benefits.** Strengthened and greener public procurement is measured by: (a) an increase in the share of non-common-use supplies and equipment mandatory under green procurement guidelines from zero in 2024 to 25 percent in 2027, and an increase from zero in 2024 to 80 percent in 2027 of e-GP procurement undertaken by Federal public bodies (excluding state-owned enterprises) with full beneficial ownership details disclosed. Green procurement will require decisions to account for environmental and climate-related costs

[15] Ethiopia 2021 Methodology for Assessing Procurement Systems (MAPS) Assessment.

[16] Per the amended law, green procurement refers to procurement and disposal of goods, services or works by public body that are environmentally friendly. It includes the establishment of systems for handling, preservation and disposal of properties that are harmful to health or to the environment, and processes whereby public bodies seek to procure goods, services and works with a reduced environmental and GHG impact throughout their life cycle when compared to goods, services and works with the same primary function that would otherwise be procured.

for the entire life cycle of procured goods. This will support climate adaptation by procuring more climate-resilient goods (e.g., construction materials and components[17]) and mitigation through the delineation of specific technical criteria to ensure that goods and works procured have low GHG emissions and that life-cycle costs that account for purchase, use and disposal (and related GHG impacts) are a critical parameter to determine award of contract. The law encourages public and private sector climate action. It lowers GHG emissions through a more significant share of non-common-use procurement mandated to consider environmental and climate-related costs. Further substantial net emissions reductions are also expected as a result of digital public procurement procedures, primarily attributed to avoided transport emissions that are equivalent to 22,000 tCO_2/year, or almost 99 percent of baseline emissions.

Prior Action 6: To increase the transparency of state-owned enterprises, (a) Ethiopian Electric Power, Ethiopian Electric Utility, Ethio Telecom, Ethiopian Agricultural Business Corporation, and Ethiopian Petroleum Supply Enterprise have published audited financial statements for 2021/22; and (b) the Ethiopia Investment Holdings and the Public Enterprise Holding and Administration have issued directives mandating state-owned enterprises under these institutions to prepare and publish audited financial statements on an annual basis effective from the next fiscal year.

Indicative Trigger 5: To increase the transparency of the public sector, the Recipient has: (a) published the 2021/22 and 2022/23 audited financial statements for the Federal Government; (b) mandated the publication of interim financial statements and budget execution reports for the Federal Government on a quarterly basis no later than the end of the quarter; and (c) mandated the Auditor General to publish audited financial statements of the Federal Government no later than 9 months after the end of each fiscal year.

60. **Rationale.** Most of Ethiopia's 42 federal SOEs are managed by two state holding companies.[18] Despite progress in improving International Financial Reporting Standards (IFRS) compliance and the completion of audits, 19 SOEs do not disclose and publish audited, IFRS-compliant statements on a regular and timely basis. Some are published with lags of several years. Transparency is limited for strategically and systemically important SOEs, limiting accountability over SOEs with large quasi-fiscal deficits that require bailouts (such as in the energy and financial sectors) and pose significant contingent fiscal liabilities.

61. **Substance:** The reforms support the publication of audited, IFRS-compliant financial reports of systemic federal SOEs, including in the energy, fuel, fertilizer, and telecom sectors. Regular publication on SOE websites will increase financial transparency and support timely monitoring of their performance and related fiscal risks. The action accords with requirements under the Financial Reporting Proclamation (847/2014) that "Public Interest Entities" (including SOEs) disclose audited financial statements through the Accounting and Auditing Board of Ethiopia, further reinforced by the State-Owned Enterprise Proclamation (1314/2016) for federally owned SOEs. As part of broader reforms, including those supported by the IMF ECF, the government is committed to making fuel procurement more effective and efficient, reducing logistics costs, and improving supply chain efficiency and reliability. The publication of the financial statements of the Ethiopian Petroleum Supply Enterprise (EPSE), which procures all national fuel imports, supports these reforms.

62. **Indicative trigger.** Public access to fiscal information is limited, reflected in a low 'D' score in the relevant

[17] For example, through replacement of older parts for such as switchgear and transformers in the electricity distribution network with more energy efficient parts, with interest expressed in this by Ethiopian Electric Utility. See 2023 Review of Ethiopian Energy Efficiency Policies (Danish Energy Agency).
[18] Ethiopian Investment Holdings manages 26 Public Enterprises Holding and Administration Agency (PEHA) manages 9. Line ministries manage the rest.
[19] This was achieved for 25 of 42 federally managed SOEs by 2022, and PEHA published audited financial statements of 19 more SOEs in 2023.

Public Expenditure and Financial Accountability (PEFA) category. The 2021 Open Budget Survey confirmed that some budget documents are still unavailable, including executive budget proposals, in-year budget reports, and year-end reports. Efforts are being made to improve public access to fiscal information. The publication of the complete 2021/22 and 2022/23 Audited Financial Statements of the Federal Government on MoF and Office of the Federal Auditor General websites and the 2022/23 draft financial statements of the Federal Government—coupled with directives mandating timely publication of future reports—would increase public access to fiscal information and increase transparency and scrutiny of government performance and resource use.

63. **Expected results and climate benefits:** Improved fiscal transparency will be measured by an increase in the share of federal SOEs with assets above ETB 15 billion that have published annual IFRS-compliant audited financial statements on their websites for each financial year from FY2021 onwards, from zero in 2024 to 90 percent in 2027. The measure also offers climate co-benefits. In particular, inefficient fuel procurement contributes to significant disruptions in fuel supply chains that lead to regular and lengthy fuel queues, contributing to GHG emissions. Financial inefficiencies also contribute to higher logistical costs for fuel imports, requiring more extensive petroleum pump subsidies. Improving the financial transparency of EPSE is a first step towards addressing these inefficiencies and reducing related GHG emissions.

Prior Action 7: To strengthen the financial sustainability of the energy sector, (a) the Ministry of Finance has issued a Directive replacing 100 percent of outstanding debt obligations from the Ethiopia Electric Power owed to the Commercial Bank of Ethiopia as of May 2024; and (b) the COM has adopted a 4-year electricity tariff adjustment, raising end-user tariffs by at least 10 percent each quarter for the first year, with the objective to move toward full recovery of operational and debt service costs for the electricity sector by 2028.

Indicative Trigger 6: To strengthen the financial sustainability in the energy sector, the Recipient has: (a) adjusted quarterly electricity tariff increases to reflect changes to the sector's cost structure arising from exchange rate, inflation, and other economic developments with the objective of achieving cost-recovery of operational and debt service costs by 2028; and (b) issued Directives: (i) preventing debt accrual on the balance sheets of EEP/EEU beyond sustainable debt service capacity; (ii) approving a Public Service Obligation (PSO) framework for the energy sector defining public policy goals, financing, accountability, monitoring, and reporting requirements; and (iii) establishing an independent system operator.

64. **Rationale:** Ethiopia's state-owned energy utilities are financially unsustainable, posing significant fiscal risks and constraining Ethiopia's ability to meet universal energy access goals. Electricity tariffs were unchanged between 2006 and 2018, and then increased by 180 percent between 2018-21. Despite these increases, current tariffs support only 18 percent of cost recovery (operational costs and debt service) because of high inflation, operational inefficiencies, and significant uncompensated public service obligations. Average tariffs, at about 3.5 US cents per kilowatt hour, are among the lowest in the world. Inadequate cost recovery has severely constrained energy access[20] and reduced service quality, negatively impacting firms, and livelihoods. Large quasi-fiscal deficits have required repeated bailouts, including three recapitalizations for EEP in the last decade. About US$2.8 billion of loans by CBE to EEP are non-performing, threatening CBE's solvency and liquidity. There are two critical challenges: to restore the sector to financial health and ensure that pending investments needed to complete significant ongoing backbone power generation and transmission projects to increase energy access and hydro exports can be financed.

65. **Substance:** A financially sustainable electricity sector is required to continue the expansion of electricity access to the 46 percent of the population deprived of service. A new four-year tariff adjustment plan will raise end-

[20] Electricity access rate is 54 percent of the population (2021).

user tariffs quarterly throughout the period and by at least 10 percent per quarter during the first year[21]. The government is committed to continue a pro-poor tariff policy during this period. The lifeline tariff (first 50kWh/month) will increase to be priced at less than half the cost of service by the end of the four-year tariff adjustment period. In addition, EEP's (non-performing) debt obligations to CBE will be written off and replaced on CBE's balance sheet by an equivalent government bond payable from the budget. Even with these measures, further sector deficits are expected, estimated at US$3.4 billion, absent more comprehensive reform and restructuring. By end-2024, a new eight-year Financial Viability Action Plan (FVAP) will be adopted to contain sector losses and improve performance. It identifies measures to: (a) implement least cost integrated generation, transmission, and distribution, (b) reduce technical and commercial losses, (c) manage FX risks, (d) sustain cost recovery through tariff reforms, and (e) establish an independent system operator. The FVAP's implementation will be supported by World Bank-financed operations (including the PRIME-1 project[22]) and will be regularly updated to reflect changing economic conditions. To strengthen oversight, a new energy reform task force led by the Ministry of Finance will provide strategic direction, leadership, and accountability for energy reforms.

66. **Indicative trigger.** Further tariff adjustments are needed to achieve cost recovery and account for currency dynamics due to macroeconomic reforms. The indicative trigger will support an interim review and adjustment of tariffs to ensure progress toward achieving full cost recovery of operational and debt service costs by 2028. The reforms also include new directives to prevent sector utilities from incurring financial deficits and ensure compliance with sector debt sustainability limits. The approval of a new Public Service Obligation (PSO) framework will compensate sector utilities on any directed obligations to provide total cost compensation (e.g., rural electrification obligations). A level playing field is required in addition to the financially healthy and creditworthy EEP as the sole off-taker to attract private sector investments. As envisioned in the planned FVAP, a new independent system operator will be established to ensure that independent power producers (IPPs) have equal access to the system and that the system operates on a level playing field.

67. **Expected results and climate benefits.** The reforms are expected to strengthen the sector's financial sustainability and improve performance by increasing the recovery of the power sector's operational costs and debt service from 18 percent in 2023 to 70 percent by end-2027. In addition to higher energy tariffs supporting climate change mitigation by incentivizing more efficient energy use, improved financial sustainability of energy utilities will enable them to adapt to climate change risks by investing in more climate resilient infrastructure—a key priority identified in the Ethiopia CCDR and LT-LEDS.

Pillar 3: Enhance Social Resilience and Climate Action

68. **Pillar 3 supports social resilience and climate action** by expanding safety nets to cushion poor households from macroeconomic reforms, improving land and forest management to benefit rural and forest communities, and strengthening environmental and impact assessments in public investment projects.

Prior Action 8: To better protect the poor and improve the management of safety nets, (a) the Recipient has committed to increase the number of beneficiaries and the benefits paid per beneficiary in both the rural and urban Productive Safety Nets Programs; and (b) the Recipient's Parliament has approved the Personal Data Protection Proclamation establishing the legal framework to protect and secure personal administrative data.

Indicative Trigger 7: To enhance the effectiveness and efficiency of social safety nets, the Recipient has: (a) expanded

[21] The pace on quarterly tariff increases will be adjusted in the second year to reflect changes to the sector's cost structure arising from exchange rate, inflation, and other economic developments with the objective of achieving cost-recovery of operational and debt service costs by 2028.
[22] Power Sector Reform, Investment and Modernization in Ethiopia (PRIME-1) (P176731). World Bank.

e-payments for rural safety net beneficiaries; (b) established a Digital ID Authority and a Data Protection Commission; (c) completed a re-assessment of existing rural Productive Safety Nets Program through an enhanced wealth-ranking methodology; and (d) approved the establishment of a National Social Registry.

69. **Rationale.** Although macroeconomic reforms are expected to generate positive impacts over the medium term, there could be adverse poverty and social impacts in the short term. Liberalizing the FX market is a pre-condition for easing policy distortions on private sector investment, job creation, remittance inflows into the economy, and in tandem with measures to increase trade integration, will strengthen export competitiveness in the agri-food trade and household incomes over the medium term. However, FX reforms are expected to increase domestic prices of final goods, reducing real incomes for urban and rural households, with the former impacted more due to greater consumption of market-purchased food and imported goods.

70. Ethiopia's longstanding safety net system could lessen negative reform impacts if strengthened. The Rural Productive Safety Nets Program (PSNP) and Urban Productive Safety Nets and Jobs Program (UPSNJP) support 9.7 million beneficiaries in 485 *woredas* and 88 cities and towns,[23] and target/support households across overlapping vulnerabilities including poverty, food insecurity, drought, and internal displacement. The presence of safety nets in fragile and conflict regions is also significant.[24] Although the largest in Africa, they face significant challenges related to financial sustainability, coverage, adequacy, and capacity to respond to shocks. There is a heavy reliance on uncertain donor financing, and the government's share of total safety net financing has steadily fallen due to fiscal constraints. Funding shortfalls have reduced benefits paid to rural public works beneficiaries (about 70 percent of all beneficiaries) to four months a year. Resources are also insufficient for safety nets to cover Ethiopia's estimated 34 million poor fully. Benefits paid to existing beneficiaries are expected to be further eroded if macroeconomic reforms lead to higher inflation.[25,26]

71. Expanding safety nets, increasing benefits, and slowing fuel and fertilizer price adjustments are the most immediate ways of moderating the poverty impact of planned macroeconomic reforms. A 35 percent increase in benefits from current levels could help contain nearly half of the welfare losses experienced by the poorest beneficiary households (in quintile 1). However, these safety net programs cover only 22 percent of the poorest quintile of the population. Further containment of the overall short-term welfare losses of FX reform requires further targeted interventions through the safety net programs and other direct measures to support the poor (e.g., school meals and health insurance). Simulations suggest that untargeted fuel and fertilizer subsidies could reduce short-term welfare losses of the macroeconomic reforms.

[23] The programs improve food security, income, and livelihoods through public works components, along with support for refugees, youth, Internally Displaced Persons (IDPs), the elderly, and other vulnerable groups. The safety nets have been progressively expanding their geographical coverage based on the evolving poverty situation as well as funding situation. Whenever a shock happens, there is a mechanism of coordination between the safety net projects and the humanitarian actors (including the Ethiopia Disaster Risk Management Commission) to respond to needs arising because of the shock.

[24] Note that Ethiopia has a total of 1,102 woredas. The urban areas are supported by the urban safety net which covers 88 cities and towns. The rural safety net covers 485 woredas which represents almost 45 percent of the total woredas. In Tigray, the rural and urban safety nets cover 56 rural *woredas* and 6 urban towns and collectively support 1.31 million people. In Amhara region, which is currently experiencing conflict, the safety net operates in 87 rural *woredas* and 18 urban towns, collectively supporting 2.1 million beneficiaries. In Afar region, which was also significantly impacted by the Tigray conflict, the safety nets operate in 35 rural *woredas* and 3 urban towns supporting 609,000 beneficiaries. The urban safety net has experience supporting conflict-induced displacement having supported IDPs in six regions (Oromia, Amhara, Afar, Benishangul-Gumuz, SNNP, and Harari) with shock-responsive cash transfers and recovery grants. This is now being expanded to Tigray and Somali regions.

[25] Benefits average ETB 323 for rural beneficiaries and about ETB 600 for urban beneficiaries per month.

[26] With most import prices already adjusted to higher (parallel market) rates, a limited passthrough is expected from the FX reform. Price pressures are expected to arise mainly from increases in administered fuel and fertilizer prices towards complete cost recovery levels that reflect market exchange rates, energy tariff reforms, and second-round impacts if traders use the FX reform to justify increased profit margins.

72. **Substance**. The prior action mitigates reform impacts on the poor and strengthens the financial sustainability of the two safety net programs. More specifically, the government has committed to raise government contributions to budgetary allocations for the urban and rural safety nets six-fold to ETB 60 billion to finance the cost of 9.7 million beneficiaries, with the increase expected to be permanent.[27] Additional commitments include adjusting benefit levels for inflation impacts in September 2024 for rural beneficiaries and January 2025 for urban beneficiaries. These two measures will be reflected in a forthcoming supplementary budget, and will allow all current beneficiaries to be funded from the national budget while also receiving an inflation adjusted increase in the first year of the reform. Additional commitments include providing temporary economic shock response support,[28] and on the basis of planned poverty assessments during FY2025 and fiscal capacity,[29] to structurally increase the number of rural and urban safety net beneficiaries by 2027. Female beneficiaries, who already represent a high share of urban (60 percent) and rural (52 percent) beneficiaries, are expected to further benefit from these measures.[30]

73. The Personal Data Protection Proclamation passed in March 2024 is a foundational reform to modernize safety nets, shift to a unified social registry, and improve safety net targeting. Current beneficiary registers already store substantial amounts of personally identifiable data. To protect personal data and build interoperable digital systems linked to *Fayda*, the law provides the legal basis for the protection/security of personal administrative data and the digital privacy of individuals. It also includes the creation of the Data Protection Commission, which is needed to enforce new rules for storing and sharing personally identifiable data. The prior action builds on a Digital ID law passed in 2023, which provided the legal basis for establishing the *Fayda* national ID system, and the ID Authority is responsible for its implementation.

74. A broader fiscal package of pro-poor measures will complement reforms supported by this prior action. As part of a budgetary envelope agreed by the government, the IMF, and the World Bank, an additional 0.5 percent of GDP will be used to subsidize gradual fuel price increases to bring pump prices to complete cost-recovery levels at market exchange rates. About 0.4 percent of GDP will be used (if needed) to moderate essential imported food price shocks. A further 0.4 percent of GDP will be set aside for further poverty reduction measures.

75. **Indicative trigger.** Reforms supported by the DPO-2 will strengthen the social safety net system by expanding e-payments to rural beneficiaries, reducing fraud, and increasing trust in the system. Establishing a Data ID Institution that oversees the implementation of the *Fayda* ID system is needed for identity proof and verification of beneficiaries. The Data Protection Commission would operationalize the new law and enhance personal data protection for beneficiaries from the most vulnerable populations. These measures represent the initial steps to developing a National Social Registry. Finally, while proxy means testing (PMT) is being undertaken for urban beneficiaries, cost and security considerations have limited the rollout of PMT in rural areas. To improve targeting in rural areas, measures support re-assessments using an enhanced wealth-ranking methodology.

76. **Expected results:** The government's commitment to expand the number of beneficiaries and benefits, and improved management of safety net programs, is captured by an increase of its contribution to the financing of the rural and urban safety net programs from less than 0.1 percent of GDP in 2023 to 0.4 percent in 2027 and by the rise in the share of female beneficiaries benefiting from the livelihoods and jobs components of the urban and rural safety

[27] Adjustments in subsequent years are likely to be in line with inflation.
[28] The government is committed to a shock response and structural expansion which will extend the safety net coverage to areas currently uncovered by the existing safety net projects. It is also expected that poor households who are not covered by the safety nets will benefit from subsidies and other measures implemented by the government to protect the poor.
[29] This would include donor contributions that would allow for an expansion of the rural and urban safety net programs.
[30] This reflects preferential targeting, e.g., through issuance of joint client cards to spouses in male-headed households, opening of joint bank accounts in the rural safety net, targeting of women in apprenticeship programs and child-care grants, trainings on basic digital literacy and linking of female beneficiaries to social services in public works programs, especially before and after giving birth.

net programs from 43 percent in 2023 to 65 percent in 2027. Most of Ethiopia's safety net beneficiaries live in areas at high risk of extreme climate events. Increasing their benefits and the number of beneficiaries in safety nets will build household climate resilience *before* shocks occur. It also helps mitigate climate risks *afterward* by reducing the poverty impact of climate events on communities. Seventy-seven percent of current beneficiaries (rural and urban combined) engage in climate-smart public works, including reforestation and land degradation prevention through watershed management, expansion of urban greenery, terracing, tree planting, soil and water conservation, and small-scale irrigation. All these activities are aligned with the mitigation and adaptation priorities of the 2021 NDC. Most of the new safety net beneficiaries included under this prior action will be supported through public works programs. The increase in overall funding for safety nets will also enable greater flexibility in the future for fast and adaptive support for the poor in response to extreme climate events.

Prior Action 9: To support sustainable land and forest management, build resilience for rural and forest communities, and reduce carbon emissions, (a) the Recipient's Parliament has approved the Rural Land Administration and Use Proclamation establishing rural land property rights; and (b) the COM has issued regulations for forest management creating a legal basis for the sale of emissions reduction.

Indicative Trigger 8: To support sustainable land and forest management, build resilience for rural and forest communities, and reduce carbon emissions, the Recipient has: (a) amended the Rural Land Law establishing land tenure and property rights categories for private and communal land ownership; (b) established implementation arrangements for forest management, including benefit sharing of revenues derived from sales of emissions reductions from improved forest management; and (c) established a benefit-sharing arrangement and title transfer of emission reductions revenue derived from the livestock sector.

77. **Rationale.** Land degradation is a significant development challenge, adversely impacting rural growth and poverty reduction and affecting one in five people. About 80 percent of the land surface is prone to moderate or severe soil degradation, and currently, some 27 million hectares (ha), or 50 percent of highlands, are eroded. The Ethiopia CCDR predicts that degradation hotspots are expected to expand, particularly in the lowlands, under future scenarios for climate change. Very high levels of land degradation and deforestation are also caused by unsustainable land management practices, expansion of subsistence farming, and the consumption of wood for domestic fuel. Weak private and communal land tenure security disincentivizes investments in land management and contributes further to land degradation. Without policy action, 56 percent of the existing forest area could be degraded by 2030. Degradation increases climate change risks by reducing agricultural and livestock productivity, increasing flood risks, and reducing hydropower output and water availability (leading to higher GHG emissions), with the CCDR recommending a strengthening of rural land tenure and land registration as a key mitigating measure. Climate change is also contributing to land degradation and erosion, with lowlands particularly vulnerable. By 2050, the resulting land degradation could reduce crop yields from 1 to 5 percent as nutrients are washed away (CCDR, 2024).

78. **Substance.** Land certification and registration in the rural highlands has incentivized sustainable land management practices.[31] The Rural Land Administration and Use Proclamation, approved by Parliament in May 2024, provides the legal framework for land certification and registration. The law is potentially transformative as it establishes: (i) the legal basis for rural land property rights for the first time since the 1975 nationalization of rural land; (ii) a system of rural land registration and certification; (iii) the right to collateralize rural land to access credit; and (iv) a unified rural land information system. Evidence shows that strengthened land tenure security increases access to credit, revenue collection potential for local governments, and reduces land disputes.

79. Forestry regulations create the legal basis for defining ownership and transfer rights for forests and the Emissions Reductions (ERs) they can generate, and provide for private farm owners, forest associations and local

[31] Some 47 million "first-level" and "second level" land certificates have been issued since 1998.

communities to receive administration and technical support from the government when transferring ER rights and use of forest assets and land as collateral to access loans and insurance. As a result, they create incentives for forest associations and local communities to manage forests and woodlands sustainably, ensuring these resources contribute to climate resilience by protecting vital ecosystem services, such as slope stabilization and soil retention. Improving the regulatory basis for forest management will help sustain forest resources as a buffer for forest-dependent communities during climate shocks.

80. **Indicative trigger.** Amendments to the Rural Land Law will establish specific land tenure and property rights categories, such as private and community ownership rights, enabling rights-holders to sell properties on land (such as houses and warehouses). Forest management directives will clarify implementation arrangements of the new forest regulations, including specific arrangements for benefit sharing of revenues derived from sales of ERs from improved forest management and for title transfer of ERs. Introducing benefit-sharing arrangements for the livestock sector will create a regulatory framework to engage livestock owners and associations to increase efficiency, productivity, and resilience. It will also incentivize efforts to reduce methane emissions by generating and selling Emissions Reductions. The livestock sector is the second largest contributor to Ethiopia's GHG emissions.

81. **Expected results and climate benefits.** Results will be captured by: (i) an increase in the area of land covered by systematic land registration as securely registered in the National Rural Land Administration Information System from 13.5 million hectares in 2024 to 23.5 million hectares in 2027; and (ii) an increase in hectares of forests managed by forest cooperatives eligible to receive revenues flows derived from the sale and transfer of Emissions Reductions from 2.5 million hectares in 2024 to 4 million hectares in 2027. Land and forest management are critical adaptation priorities in the 2021 NDC. The NDC sets targets for increased hectares of reforested/restored land (to 9 million ha by 2030) and increased earnings from sustainable forest products, a variant of which is captured in the result indicator on sale of Emissions Reductions. In addition to supporting climate mitigation through the trade of Emissions Reductions, several studies suggest that Second Level Landholding Certificates (SLLCs) strongly and directly impact reduced land degradation, a significant problem arising from climate-related hazards in Ethiopia.[32] Land management investments are frequently financed through loans that require land certificates as collateral. These investments often involve shifting to perennial tree crops to stabilize slopes, sequester carbon, and generate higher returns at the household level. Adaptation benefits arise from increased investments in soil and water conservation practices, such as terracing and contour bunding, that increase resilience to floods and droughts.[33] Forestry regulations incentivize forest associations and local communities to manage forests and woodlands sustainably and enhance climate resilience by protecting vital ecosystem services, such as slope stabilization and soil retention, offering both mitigation and adaptation benefits. Improving the regulatory basis for forest management will help sustain forest resources as a buffer for forest-dependent communities against climate and economic shocks.

Prior Action 10: To strengthen the management of environmental and social risks, the COM has submitted to Parliament amendments to the Environmental Impact Assessment (EIA) Proclamation establishing enhanced mechanisms and procedures for environmental and social impact assessments in investment projects.

[32] Adere et al. (2022) The Impact of Land Certification and Risk Preferences on Investment in Soil and Water Conservation: Evidence from Southern Ethiopia, Land Use Policy Volume 123; and the UNCCD Report (2022) provide an overview of these analyses.
[33] Landholders with SLLCs were 13 percent more likely to invest in land conservation practices, 15 percent more likely to plant crops that reduce soil erosion (including from climatic events), and 33 percent more likely to undertake general land improvement investments that include measures to reduce land degradation. LIFT Evidence Note on the impact of second level land certification on tenure security, investment and incomes (2021).

Indicative Trigger 9: To strengthen the management of environmental and social risks, the Recipient has: (a) through its Environmental Protection Agency, issued a Directive establishing guidelines on public participation in social, climate change, and environmental impact assessments; and (b) through its Ministry of Planning and Development, has integrated climate considerations into public investment management and capital budgeting regulations.

82. **Rationale.** Existing Environmental Impact Assessment (EIA) legislation mandated EIAs for major investment projects and integrated environmental, economic, and other social considerations to promote sustainable investment. The amendment to the Proclamation was proposed in 2021 and its adoption by the COM and subsequent approval by Parliament, coupled with the broader strengthening of the ESIA system, will enhance the preparation, review, and approval of investment projects to ensure that they effectively address environmental and social risks.

83. **Substance**. The amendments to the EIA Proclamation (No 1263/2021) will strengthen the legal framework for environmental and social risk management, through: (i) the revocation of powers relating to the administration of environmental and social impact assessments (ESIAs) from six sector line ministries back to Environmental Protection Agency (EPA); (ii) integrating social impact assessment and climate change risk assessment into ESIA procedures and practices; and (iii) strengthening requirements and procedures for public consultation. The amendments will strengthen the mandate of the EPA as a key regulatory body and will address important gaps with regards to the assessment of social and climate change risks. The amendment also introduces other measures to strengthen the ESIA legal framework. In particular, the EPA has recently developed procedural guidelines for climate change risks assessments which will be used to integrate climate change adaptation and mitigation considerations into the ESIA.

84. **Indicative trigger**. The trigger will introduce specific directives on critical aspects of implementing the amended proclamation, including social risk assessment, climate risk assessment, and public participation. The reforms supported by the DPO-2 will integrate climate risk management into public investment and capital budgeting.

85. **Expected results and climate benefits.** The development of a well-functioning and efficient ESIA system is captured by an increase in the share of new public sector projects in agriculture, manufacturing, mining, and transport sectors that consider and include specific mitigation measures to address environmental (including climate) and social risks in accordance with the amended ESIA Proclamation to 40 percent. Reforms supported by the prior action are consistent with the recommendations of the CCDR, Ethiopia's LT-LEDS and CRGE strategy and support implementation of commitments under the updated NDC and NAP (i.e., both mitigation[34] and adaptation). The 2021 NDC identifies strengthened capacity of federal/regional institutions and public sector agencies as a key measure of improved adaptation and essential for better managing forest and land resources.

86. **Analytical underpinnings.** The DPO builds on solid analytics and is informed by lessons from recent operations in Ethiopia (see Annex 4). The regulatory framework underpinning the DPO was developed through multiple consultations by government counterparts and reflects the World Bank's and partners' experience in Ethiopia.

4.3. LINK TO CPF, OTHER BANK OPERATIONS AND THE WBG STRATEGY

87. **The DPO series is aligned with the forthcoming Ethiopia Country Partnership Framework (CPF, FY2025-**

[34] Per the amended law's provisions, environmental audits of projects are required at a minimum every two years, with requirements to report on (among other key criteria) energy consumption, waste management and environmental management plans; these audits are necessary for renewed authorization to continue project implementation and can trigger regulatory action where warranted (with the law providing for this).

30) and complements other World Bank-financed projects. There are complementary IDA operations in social safety nets, energy, finance, agriculture, land management, transport, and trade logistics. A recently approved Power Sector Reform, Investment, and Modernization project (PRIME-1, P176731) will support energy reforms. A US$70 million Governance Modernization Project supporting revenue mobilization and US$700 million Financial Sector Strengthening Project (FSSP) to support CBE's reforms, both currently under preparation, are expected to be presented to the Board in FY2025.

4.4. CONSULTATIONS AND COLLABORATION WITH DEVELOPMENT PARTNERS

88. **Actions supported by this DPO series are included under the government's new HGER 2.0.** The government has actively consulted with academia, the private sector, civil society, the media, and partners to build awareness on critical reforms, including the exchange rate, energy tariffs, and the liberalization of economic sectors. In June 2023, the government conducted a technical consultation on the HGER 2.0 with the Development Assistance Group, a government-donor platform for aid coordination. In March 2024, at a High-Level Development Forum, the government engaged in consultations with 34 bilateral and multilateral development partners, private sector and civil society; participants welcomed the government's commitment to undertake macroeconomic reforms as outlined in the Homegrown Economic Reform 2.0, peace building and consolidation efforts, and resilience building.[35] As part of public consultations on the FY2024/25 budget, the government also engaged with stakeholders on the need to mobilize revenues, reprioritize spending, and expand safety nets. Land reforms have involved extensive consultations at the federal, regional and *woreda* level, while the land certification and registration process facilitating the implementation of the reform (with technical support provided by Finland, UK FCDO, and the World Bank) was highly consultative, extending to the household level. Pilots have demonstrated household and local support for the policy reforms supported by the DPO series. The World Bank has also consulted extensively with development partners to ensure a robust and coordinated response to Ethiopia's reform program. A Poverty Assessment is under preparation, with preliminary findings discussed with the authorities, with plans for broader stakeholder consultations once finalized. A multi-donor trust fund established in 2021 provides comprehensive and coordinated technical assistance to implement DPO-supported reforms. The DPO series may also form the basis for parallel budget support from other development partners.

5. OTHER DESIGN AND APPRAISAL ISSUES

5.1. POVERTY AND SOCIAL IMPACT

89. **Reforms supported by this DPO and other complementary reforms the government will implement will likely generate adverse short-term poverty and social impacts.** The poverty and social impact analysis focuses on the prior actions under this operation.

90. **Prior actions on domestic revenue mobilization (PA4) and financial sustainability of the energy sector (PA7) are likely to have small negative impacts on households' welfare, particularly for urban households.** The ending of VAT exemptions for electricity (except for the lifeline block) will have minimal effect on households' welfare. Essential food items, notably cereals[36], injera, bread, and milk also remain exempt, as are key agricultural inputs.[37]The increase in electricity tariffs (PA7) will have a small negative impact on households connected to the grid.[38] Welfare losses as a share of household expenditures will be highest amongst the poorest three quintiles and urban households though the social tariff scheme helps contain the impact. These welfare losses will accumulate

[35] https://ethiopia.un.org/sites/default/files/2024-03/HLDF%20Joint%20Communique%20-%2014%20March%202024.pdf
[36] Including teff, barley, wheat, maize, sorghum, millet, oats, peas, beans, lentils, chickpeas and more.
[37] These include fertilizer, pesticides, seeds, and veterinary medicines.
[38] 46 percent of the population currently do not have access to electricity services.

over four years in line with the tariff adjustments and households' income growth trajectory. Ethiopia's poor spend close to 9 percent of their income on energy sources but spending on electricity is low because of limited access to the public electric grid and unreliable service. Improved financial sustainability in the energy sector that lowers electricity outages will positively impact firm entry and employment. More predictable funding for safety nets, the structural increase in safety net beneficiaries and inflation adjustments (PA8) and shock response scale-up will help mitigate impact of macroeconomic reforms. Ethiopia's safety nets have built in flexibility to address multiple dimensions of vulnerability and poverty through public works-linked cash and food transfers, direct cash and food transfers, shock-responsive cash and food transfer support, tailored livelihood enhancement interventions and linkages to available social services, IDPs and youth apprenticeships, and geographical targeting has been influenced by the nature of crises, such as droughts, COVID-19, and conflict-driven displacements. Welfare and poverty impact monitoring is being strengthened through World Bank technical assistance to the government (See Annex 6).

91. **Prior actions on agricultural exports (PA3) and rural land reform (PA9) are likely to have a net positive impact on rural incomes if there are no disruptions to production**. The removal of the export ban on cereals (PA3) could raise concerns about food security, given the recent food price inflation. However, evidence from Ethiopia's agriculture sector indicates a net positive impact of trade liberalization, provided that maize production and supply are not disrupted.[39] Maize is grown by 62 percent of all rural households, including 58 percent of the poorest quintile. Absent disruptions to cereal production and marketing, the removal of export bans is unlikely to lead to food price increases given their distortionary effects, as well as analyses of Ethiopia's competitiveness in meeting regional demand for maize. The removal of export bans could positively affect producers' incomes by boosting market access and converting unusable food surpluses into income opportunities. Rural land reform (PA9) creates opportunities for rural income gains as a strengthened system of, and increased registration and certification of land will help to consolidate currently fragmented land holdings, and use of land as collateral will boost household investments and support mechanization and a shift to perennial crops. Concerns about food security are alleviated by the availability of strategic grain reserves and efforts to introduce modern technologies for grain storage (e.g., improved silo systems), to reduce post-harvest losses and enhance storage efficiency. These reforms would facilitate improved secondary and rental land markets, significantly improving land resource allocation and supporting higher economic productivity.

5.2. ENVIRONMENTAL, FORESTS, AND OTHER NATURAL RESOURCE ASPECTS

92. **Ethiopia's legal framework adequately supports the government's policy response to climate change.** Although Ethiopia lacks dedicated climate change legislation, its constitution includes provisions for protecting the environment, the sustainable use of natural resources, and the treatment of ratified international agreements as a fundamental part of domestic law. It also assigns significant subnational responsibilities in climate-affected sectors like agriculture, health, transport, and urban infrastructure. Most industry and administrative laws include relevant provisions that can be used to develop and enforce climate change regulations and standards. Ethiopia has an ambitious policy-backed program of sustainable land management, supported by a national program of land certification to strengthen land tenure, which helps build climate resilience and contributes to climate mitigation goals from the land use sector. The CRGE strategy also outlines policies and plans to support greener development and adaptation to climate change. It establishes arrangements for reporting on UNFCCC commitments, including the targets in the updated NDC submission document to the UNFCCC. In practice, these are only partially implemented, with quantifiable impacts of climate change interventions challenging to discern due to a lack of necessary tracking mechanisms, monitoring, reporting, and verification protocols.

93. **Prior actions in this DPO are expected to have a positive or neutral environmental impact**. Actions in Pillars

[39] World Bank. Ethiopia Country Economic Memorandum (2022).

1 and 2 are unlikely to have direct impacts. Indirect adverse effects could stem from actions to improve the business climate and foster investment. This risk should be viewed in the context of weak institutional capacity to manage potentially harmful effects of investment projects, including the weak system for conducting ESIAs and enforcing compliance with results. Pillar 3 actions strengthen the overall system for ESIA implementation, increase transparency and public participation, and improve the integration of social and climate change aspects. Reforms in Pillar 3 will likely generate significant positive benefits for managing the environment, forests, and natural resources. Reforms to strengthen rural land administration are expected to increase incentives for household and community investments in sustainable land and natural resources management. Strengthened forestry regulations for the management of natural and plantation forests and for sharing the benefits from these forests—including benefits from the sale of forest carbon emissions reductions—are expected to incentivize sustainable forest management at the private and community levels. Pillar 3 actions strengthen the ESIA system, while triggers include strengthening environmental and climate risk screening into public investment management and capital budgeting.

5.3. PFM, DISBURSEMENT AND AUDITING ASPECTS

94. **The government's public financial management (PFM) system and public procurement framework provide reasonable assurances that budget resources are managed appropriately.** The government has recently demonstrated its commitment to modernizing and reforming the PFM cycle to improve efficiency and effectiveness. Foundational legal frameworks, regulations, and directives have been issued. Basic public procurement systems have been established at all levels of the government. The government has also instituted reforms to reduce fraud and corruption through Federal Ethics and Anti-Corruption Commission and Regional Ethics and Anti-Corruption Commission. Key oversight institutions such as Office of the Federal Auditor Genera (OFAG) and Office of the Regional Auditor General (ORAG) play a pivotal role in conducting audits of the Federal and regional governments. The FPPA oversees public procurement, and the Accounting and Auditing Board of Ethiopia oversees professional standards for accounting and auditing.

95. **The strength of the PFM system also includes reasonable budget procedures.** The Federal Government's enacted Budget is published in the Government's official publication (the Negarit Gazette), and a Citizen's Budget is also disclosed on the MoF website. However, the executive budget proposal document is not disclosed to the public before submission to the legislature. The MoF has started disclosing in-year budget execution reports, though improvements are needed in quality and content. Audited annual financial reports are disclosed to the public by OFAG and MoF, with the latter starting to publish some extracted statements on its website. Reasonable payroll management and controls exist, and digital solutions (IFMIS, IBEX, and e-procurement) are increasingly used at the federal level.

96. **Considerable weaknesses in PFM and Procurement remain noted in PEFA and MAPS assessments.** Challenges include weaknesses in revenue/tax collection; public access to budget information; issues with program budgeting; comprehensiveness of the budget documents; variability in budget outturn significantly worsening composition variance; ensuring medium-term perspectives and budget linkages with sectors; unreported extra-budgetary funds; weaknesses in internal and external audit; internal control; limitations on parliamentary oversight; and in the governance and transparency of SoE financial management and reporting. A MAPS study identified significant weaknesses in public procurement, as indicated in the rationale for PA5 on procurement reforms supported in this DPO. Conflicts have further impacted PFM at local levels. A PFM reform strategy (2023-2028) has been developed alongside a procurement reform strategy and action plan to alleviate these gaps. A US$70 million Governance Modernization project under preparation will focus on critical governance reforms, including PFM, with DPO policy interventions reinforcing planned reforms.

97. **The Central Bank maintains sufficient operational and foreign exchange management controls.** The last

IMF Safeguard Assessment was in 2020, and some progress has been made to implement its recommendations. Key issues include the need for stronger FX management and controls, greater FX reserve diversification, auditor rotation, better internal audit capabilities, and stronger portfolio risk management. The most recent NBE audit report is for the financial year 2020/2021, and there is now a two-year backlog of audits. In the unmodified 2020/2021 audit, auditors (without qualifying their opinion) reported a "Material Uncertainty Related to Going Concern" relating to operational losses due to a net capital deficiency arising from the impairment of securities/loans/advances and currency depreciation. In response to sustainability concerns, the government has informed the World Bank that the NBE's Board and Management and MoF have developed a "recapitalization plan" to improve the NBE's balance sheet. Audit reviews indicating deficiencies in internal controls have been shared with management. These include the absence of some foreign account confirmations, confirmation of foreign accounts showing differences with the ledger, unreconciled balances of currency in circulation, and delays in implementing internal audit findings. NBE has an internal audit and risk management directorate reporting to its Board. Findings are being followed up through an action plan, but more work is needed to address all the audit findings.

98. **Disbursement and Accounting**. The operation will follow World Bank standard disbursement procedures for development policy financing (DPF). To mitigate risks, the DPF proceeds from the World Bank will be deposited into a dedicated deposit account (a government foreign currency account) at the NBE. The Recipient, represented by MoF, within 30 days after the withdrawal of the financing, will report to IDA: (a) the exact sum received into the dedicated account referred above, (b) the details of the account to which the Ethiopian Birr equivalent of the financing proceeds will be credited, (c) the record that an equivalent amount has been accounted for in the Recipient's budget management systems, and (d) the statement of receipts and disbursement of the dedicated account. The Recipient may not use proceeds from this DPO to finance any excluded or negative items defined in the IDA Financing Agreement.

99. **Auditing arrangements**. Given substantial fiduciary risks, the MoF will submit an audit of the dedicated deposit account by independent auditors acceptable to the Association. The MoF would: (i) furnish to the Association as soon as available, but in any case not later than three months after the end of the fiscal year, a certified copy of the report of such audit, of such scope and in such detail as the Association shall reasonably request, and make such report publicly available in a timely fashion and a manner acceptable to the Association; and (ii) furnish to the Association such other information concerning the dedicated deposit Account and related audit as the Association shall reasonably request.

5.4. MONITORING, EVALUATION AND ACCOUNTABILITY

100. **MoF will coordinate monitoring and evaluation.** MoF will lead in establishing a mechanism for coordination among all relevant agencies and other stakeholders to monitor the results indicators and evaluation activities. Program outcomes will be monitored through the Policy and Results Matrix (Annex 1). Line ministries or agencies will be responsible for tracking relevant indicators. MoF will collect and share such information with the World Bank. The World Bank remains committed to providing technical assistance to support timely and effective reform implementation and robust data collection, monitoring, and evaluation of reform progress.

101. **Grievance Redress.** Communities and individuals who believe that they are adversely affected by specific country policies supported as Prior Actions or tranche release conditions under a World Bank Development Policy Operation may submit complaints to the responsible country authorities, appropriate local/national grievance mechanisms, or to the Bank's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed to address pertinent concerns. Project-affected communities and individuals may submit complaints to the Bank's independent Accountability Mechanism (AM). The AM houses the Inspection Panel, which determines whether harm occurred or could occur due to the Bank's non-compliance with its policies and

procedures, and the Dispute Resolution Service, which provides communities and borrowers with the opportunity to address complaints through dispute resolution. Complaints may be submitted anytime after concerns have been brought directly to the World Bank's attention and Bank Management has been allowed to respond. For information on submitting complaints to the World Bank's corporate Grievance Redress Service (GRS), please visit http://www.worldbank.org/GRS. For information on how to submit complaints to the Bank's Accountability Mechanism, please visit https://accountability.worldbank.org.

6. SUMMARY OF RISKS AND MITIGATION

102. **There is a high overall risk that the PDO will not be fully achieved.** Table 7 highlights key risks and measures to mitigate them, which are summarized below.

103. **Political and governance, social, and stakeholder risks are high**. The complex reform agenda comes at a time of conflict and social tensions in Ethiopia, and ahead of a national election in 2026. Entrenched opposition by vested interests to market-oriented reforms, including the liberalization of foreign exchange, finance, and trade, could impact the transition to a private-sector-led growth model. Given the prominence of SOEs, efforts to introduce arms-length governance for the CBE, constrain lending to insolvent SOEs may attract opposition from stakeholders. Mitigation measures include the strong government ownership of the DPO-supported reforms, the broader macroeconomic adjustment program, and alignment of reforms with government strategies and commitments expressed in national and international fora. The IMF ECF and sector-specific engagements further mitigate these risks. Pro-poor reforms supported by this DPO (e.g., lifting of cereals export bans, rural land and forestry reforms, safety net expansions) and several measures in the IMF ECF (e.g., temporary fuel and fertilizer subsidies, phasing out of surrender requirements that benefits farmers and remittance earners) mitigate social risks, but only partially given very high residual risks stemming from the complex nature and multiple drivers of inter- and intra-regional social and ethnic tensions that are being exacerbated by climate change, and existing high displacement and economic insecurity.[40]

104. **Macroeconomic risks are high.** The desired outcomes of this operation depend on a market-reflective exchange rate, prudent monetary and fiscal reforms, and timely debt treatment. A widening parallel exchange rate market gap would affect economic activity and fiscal and external balances. Ethiopia's low level of revenue collection is high risk because it could compromise the availability of finance for complementary investments to accompany this operation (such as the reduction of quasi-fiscal deficits in the energy and banking sectors), slow the moderation of debt sustainability pressures, and limit the ability to absorb shocks. Energy sector prices will need to be adjusted further to prevent macro-fiscal spillovers. Slower quasi-fiscal deficit reduction will continue to crowd out private sector access to finance and other resources, depressing longer-term growth prospects. An intensification of conflict also presents high macroeconomic risks through potential inflationary and growth pressures and a potential disruption to foreign aid flows. Frontloaded reforms would help mitigate risks (e.g., of the kind that arose during the 2019-21 DPOs when shocks derailed a gradual approach to exchange rate reform). These risks are further mitigated by the complementarity between the DPO series, the IMF ECF, and other operations that promote private investment and alleviate the fiscal dangers over time.

105. **Sector strategy and policies and institutional capacity for implementation and sustainability risks are high.** The series supports a complex and multi-sectoral reform program subject to high risk given the magnitude of challenges, especially in finance and energy. The effectiveness of reforms to restructure the CBE, mobilize revenues, and achieve cost-reflective electricity tariffs, e.g., will depend on the government's ability to apply and enforce new

[40] World Bank. Ethiopia Systematic Country Diagnostic (2024).

provisions and build regulatory capacity. In several DPO-supported reform areas, reform implementation will depend on effective collaboration and coordination across federal and subnational agencies. The MoF has been central in defining the reform agenda, DPO policy actions, their potential impact on the budget, and the responsibilities of the actors in charge of implementing policy. Reforms are supported by technical assistance from the World Bank, IMF, and other development partners.

106. **Fiduciary risks are substantial** due to challenges related to weak capacity, staff turnover at public bodies, and a weak internal audit function. There are also difficulties in procurement and property management, including record keeping, monitoring, and auditing procurement activities. There are delays in procurement, and lack of accountability for delays. Mitigation measures include reforms to strengthen PMF systems, as laid out in the PFM and procurement reform strategies, and measures supported in the DPO series.

107. **Technical design risks are substantial.** Technical design risks are significant in the banking and energy sectors. Resolving issues in these sectors is technically complex, will take time, and could generate sizeable additional financing needs given the size of quasi-fiscal deficits and the challenges they face. However, risks are moderate for other reforms supported by the DPO series. The government's commitment to reforming the financial sector and achieving full-cost recovery in the energy sector, the DPO's programmatic design, and strong support from complementary World Bank-financed projects in the financial and energy sectors will help mitigate these risks.

Table 7: Summary Risk Ratings

Risk Categories	Rating
1. Political and Governance	High
2. Macroeconomic	High
3. Sector Strategies and Policies	High
4. Technical Design of Project or Program	Substantial
5. Institutional Capacity for Implementation and Sustainability	High
6. Fiduciary	Substantial
7. Environment and Social	High
8. Stakeholders	High
9. Other	
Overall	High

ANNEX 1: POLICY AND RESULTS MATRIX

Prior Actions and Triggers		Results		
Prior Actions under DPO 1	**Indicative Triggers for DPO 2**	**Indicator Name**	**Baseline**	**Target**
PILLAR 1: ADVANCE FINANCIAL SECTOR RESTRUCTURING AND TRADE LIBERALIZATION				
FINANCIAL STABILITY AND INTERMEDIATION **Prior Action 1:** To strengthen the central bank's oversight of the banking sector, the Council of Ministers (COM) has submitted to Parliament amendments to the Establishment Proclamation for the National Bank of Ethiopia enhancing the independence of the NBE and its mandate to promote financial stability. **Prior Action 2:** To strengthen financial stability and intermediation, (a) the COM has submitted to Parliament the draft Banking Business Proclamation; (b) the NBE has issued five directives that strengthen regulations for (i) asset classification and provisioning; (ii) related party transactions; (iii) large exposures; (iv) fit and proper requirements for bank boards; and (v) corporate governance and (c) the COM has adopted a Reform, Restructuring and Recapitalization Plan for Commercial Bank of Ethiopia (CBE).	**Indicative Trigger 1:** To strengthen financial stability and improve competition in the banking sector, the Recipient has (a) enacted the NBE Establishment Proclamation and the Banking Business Proclamation; and (b) through the NBE, has issued Directives: (i) operationalizing key elements of the bank resolution framework; (ii) prohibiting the issuance of letters of credit without adequate foreign exchange coverage; (iii) enhancing risk management of net open positions, related party transactions, and large exposures; and (iv) allowing foreign investment in the banking sector.	**RI1:** Lending by commercial banks to the private sector as a share of total domestic banking sector assets. (Of which: Commercial Bank of Ethiopia's lending to the private sector as a share of its total assets). **RI2:** CBE's compliance with Basel Core Principles regulations on the independence, fitness, and propriety of supervisory board members **RI3:** Compliance of NBE capital adequacy directives with Basel Core Principles.	45% (2023) (CBE: 20%) Not compliant (2023) NBE Capital adequacy directives are not consistent with Basel Core Principles. (2023)	55% (2027) (CBE: 30%) Fully compliant, and at least 30% of CBE board members are independent. (2027) NBE Capital adequacy directives are consistent with Basel Core Principles. (2027)
TRADE INTERMEDIATION **Prior Action 3:** To support agricultural exports, the Ministry of Trade and Regional Integration, has: (a) issued two directives lifting export bans on maize and sorghum, and on barley; and (b) submitted a tariff offer to the AfCFTA aligning tariffs on trade in goods to AfCFTA standards.	**Indicative Trigger 2**: To promote trade, the Recipient has: (i) implemented the tariff offer to the AfCFTA aligning tariffs on trade in goods to AfCFTA standards; and (ii) adopted AfCFTA protocols on digital trade, investment, and competition policy.	**RI4:** Total volume of agricultural exports (metric tons/year).	1.2 million (2023)	1.6 million (2027)
PILLAR 2: PROMOTE FISCAL TRANSPARENCY AND SUSTAINABILITY				

Prior Actions and Triggers		**Results**		
Prior Actions under DPO 1	**Indicative Triggers for DPO 2**	**Indicator Name**	**Baseline**	**Target**
REVENUE MOBILIZATION **Prior Action 4:** To increase revenues from the value-added tax (VAT), the COM has submitted to Parliament amendments to the VAT Proclamation that: (a) reduce the number of items exempted for VAT; (b) limit the zero-rating for VAT purposes to only exported and re-exported items; (c) permit voluntary VAT registration by currently exempted businesses; and (d) grants exclusive authority to the Federal Government to collect the VAT.	**Indicative Trigger 3:** To improve the efficiency and equity of tax collection, the Recipient has: (a) enacted the VAT Proclamation and issued implementing regulations for the VAT Proclamation; (b) consolidated presumptive income tax rates; (c) raised thresholds for the personal income tax; (d) rationalized tax holidays; (e) introduced advance payments for the corporate income tax; (f) enacted the Property Tax Proclamation enabling Regional Governments to collect property taxes.	**RI5:** Annual Value Added Tax collection, % of GDP.	1.2% (2023)	2.4% (2027)
PROCUREMENT EFFICIENCY AND TRANSPARENCY **Prior Action 5:** To support more efficient, transparent, and sustainable procurement, the Recipient's Parliament has approved the Federal Public Procurement and Property Administration Proclamation mandating the use of e-procurement and the incorporation of green procurement principles.	**Indicative Trigger 4:** To strengthen public procurement, the Recipient has: (a) amended the Federal Public Procurement and Property Administration Proclamation to: (i) expand its applicability to public bodies, including federal public entities; and (ii) mandate the disclosure of beneficial ownership; (b) mandated the Federal Public Procurement and Property Authority to conduct performance audits; and (c) mandated the use of the e-GP system for all public entities.	**RI6:** Share of the non-CSEs (common use supplies and equipment) that have become mandatory under the Green Public Procurement. **RI7:** Percentage value of Federal public procurements being undertaken by Federal public bodies excluding enterprises through the e-GP and with full beneficial ownership details disclosed, by each of the bodies.	0% (2024) 0% (2024)	25% (2027) 80% (2027)
PUBLIC SECTOR TRANSPARENCY **Prior Action 6:** To increase the transparency of state-owned enterprises, (a) Ethiopian Electric Power, Ethiopian Electric Utility, Ethio Telecom, Ethiopian Agricultural Business Corporation, and Ethiopian Petroleum Supply Enterprise have published audited financial statements for 2021/22; and (b) the Ethiopia Investment Holdings and the	**Indicative Trigger 5:** To increase the transparency of the public sector, the Recipient has: (a) published the 2021/22 and 2022/23 audited financial statements for the Federal Government; (b) mandated the publication of interim financial statements and budget execution reports for the Federal Government on a quarterly basis no later than the end of the quarter; and (c) mandated	**RI8**: Percentage of federal SOEs with assets greater than ETB 15 billion that have published annual audited financial statements compliant with International Financial Reporting Standards for each financial year since FY21.	0% (2024)	90% (2027)

Prior Actions and Triggers		Results		
Prior Actions under DPO 1	**Indicative Triggers for DPO 2**	**Indicator Name**	**Baseline**	**Target**
Public Enterprise Holding and Administration have issued directives mandating state-owned enterprises under these institutions to prepare and publish audited financial statements on an annual basis effective from the next fiscal year.	the Auditor General to publish audited financial statements of the Federal Government no later than 9 months after the end of each fiscal year.			
ENERGY SUPPLY **Prior Action 7:** To strengthen the financial sustainability of the energy sector, (a) the Ministry of Finance has issued a Directive replacing 100 percent of outstanding debt obligations from the Ethiopia Electric Power owed to the Commercial Bank of Ethiopia as of May 2024; and (b) the COM has adopted a 4-year electricity tariff adjustment, raising end-user tariffs by at least 10 percent each quarter for the first year, with the objective to move toward full recovery of operational and debt service costs for the electricity sector by 2028.	**Indicative Trigger 6:** To strengthen the financial sustainability in the energy sector, the Recipient has: (a) adjusted quarterly electricity tariff increases to reflect changes to the sector's cost structure arising from exchange rate, inflation, and other economic developments with the objective of achieving cost-recovery of operational and debt service costs by 2028; and (b) issued Directives: (i) preventing debt accrual on the balance sheets of EEP/EEU beyond sustainable debt service capacity; (ii) approving a Public Service Obligation (PSO) framework for the energy sector defining public policy goals, financing, accountability, monitoring, and reporting requirements; and (iii) establishing an independent system operator.	**RI9:** Recovery of the power sector's operational costs and debt service.	18% (2023)	70% (2027)
PILLAR 3: ENHANCE SOCIAL RESILIENCE AND CLIMATE ACTION				
EXPANSION OF SOCIAL SAFETY NETS **Prior Action 8:** To better protect the poor and improve the management of safety nets, (a) the Recipient has committed to increase the number of beneficiaries and the benefits paid per beneficiary in	**Indicative Trigger 7:** To enhance the effectiveness and efficiency of safety nets, the Recipient has: (a) expanded e-payments for rural safety net beneficiaries; (b) established a Digital ID Authority and a Data Protection Commission;	**RI10:** Government contribution to the financing of rural and urban safety nets, % of GDP.	less than 0.1% (2023) 43% (2023)	0.4 (2027) 65% (2027)

Prior Actions and Triggers		Results		
Prior Actions under DPO 1	**Indicative Triggers for DPO 2**	**Indicator Name**	**Baseline**	**Target**
both the rural and urban Productive Safety Nets Programs; and (b) the Recipient's Parliament has approved the Personal Data Protection Proclamation establishing the legal framework to protect and secure personal administrative data.	(c) completed a re-assessment of existing rural Productive Safety Nets Program through an enhanced wealth-ranking methodology; and (d) approved the establishment of a National Social Registry.	**RI11**: Share of female beneficiaries benefitting from the livelihoods and jobs components of the urban and rural safety net programs.		
LAND AND FOREST MANAGEMENT **Prior Action 9:** To support sustainable land and forest management, build resilience for rural and forest communities, and reduce carbon emissions, (a) the Recipient's Parliament has approved the Rural Land Administration and Use Proclamation establishing rural land property rights; and (b) the COM has issued regulations for forest management creating a legal basis for the sale of emissions reduction.	**Indicative Trigger 8:** To support sustainable land and forest management, build resilience for rural and forest communities, and reduce carbon emissions, the Recipient has: (a) amended the Rural Land Law establishing land tenure and property rights categories for private and communal land ownership; (b) established implementation arrangements for forest management, including benefit sharing of revenues derived from sales of emissions reductions from improved forest management; and (c) established a benefit-sharing arrangement and title transfer of emission reductions revenue derived from the livestock sector.	**RI12:** Hectares of forest area managed by forest cooperatives that are eligible to receive revenues from the sale and transfer of emissions reductions. **RI13:** Hectares of landholdings that are securely registered in operational National Rural Land Administration Information System.	2.5 million (2024) 13.5 million (2024)	4 million (2027) 23.5 million (2027)
CLIMATE ACTION **Prior Action 10:** To strengthen the management of environmental and social risks, the COM has submitted to Parliament amendments to the Environmental Impact Assessment (EIA) Proclamation establishing enhanced mechanisms and procedures for environmental and social impact assessments in investment projects.	**Indicative Trigger 9:** To strengthen the management of environmental and social risks, the Recipient has: (i) through its Environmental Protection Agency, issued a Directive establishing guidelines on public participation in social, climate change, and environmental impact assessments; and (ii) through its Ministry of Planning and Development, has integrated climate considerations into public investment management and capital budgeting regulations.	**RI14:** Share of new public sector projects in the agriculture, manufacturing, mining, and transport sectors that consider and include specific mitigation measures to address environmental and social risks in accordance with the amended ESIA Proclamation.	0% (2024)	40% (2027)

RESULTS INDICATORS BY PILLAR

Baseline	Closing Period
Pillar 1: Advance financial sector restructuring and trade liberalization	
Lending by commercial banks to the private sector as a share of total domestic banking sector assets (Percentage)	
May/2023	Jun/2027
45	55
Lending by the Commercial Bank of Ethiopia to the private sector as a share of its total assets (Percentage)	
May/2023	Dec/2026
20	30
CBE's compliance with Basel Core Principles regulations on the independence, fitness, and propriety of supervisory board members (Yes/No)	
Nov/2023	Dec/2026
No	Fully compliant and at least 30% of CBE board members are independent
Compliance of NBE capital adequacy directives with Basel Core Principles. (Yes/No)	
Dec/2023	Dec/2027
NBE capital adequacy directives are not consistent with Basel 1 or current Basel Core Principles.	NBE capital adequacy directives are consistent with Basel Core Principles.
Total volume of agricultural exports (Metric tons/year)	
Jun/2023	Jun/2027
1.2 million	1.6 million
Pillar 2: Promote fiscal transparency and sustainability	
Annual Value Added Tax collection, percent of GDP (Percentage)	
Jun/2023	Jun/2027
1.2	2.4
Share of the non- common use supplies and equipment that have become mandatory under the Green Public Procurement. (Percentage)	
Jun/2024	Jun/2027
0	25
% value of Federal public procurements being undertaken by Federal public bodies excluding enterprises through the e-GP and with full beneficial ownership details disclosed, by each of the bodies. (Percentage)	
Jun/2024	Jun/2027
0	80
Percentage of Federal SOEs with assets greater than ETB 15 billion that have published annual audited financial statements compliant with IFRS for each financial year since FY21 (Percentage)	
Jun/2024	Jun/2027

0	90
Recovery of the power sector's operational costs and debt service. (Percentage)	
Jun/2023	Jun/2027
18	70
Pillar 3: Enhance social resilience and climate action	
Government contribution to the financing of rural and urban safety nets, % of GDP (Percentage)	
Jun/2023	Jun/2027
less than 0.1	0.4
Share of female beneficiaries benefitting from the livelihoods and jobs components of the urban and rural safety net programs. (Percentage)	
Jun/2023	Jun/2027
43	65
Forest area managed by forest cooperatives that are eligible to receive revenues from the sale and transfer of emissions reductions. (Hectare(Ha))	
Jun/2024	Jun/2027
2.5 million	4 million
Hectares of landholdings that are securely registered in operational National Rural Land Administration Information System. (Number)	
Jun/2024	Jun/2027
13.5 million	23.5 million
Share of new pub. sector proj. in ag., mfg., mining, and trans. sectors that consider and include specific mitigation measures to address env. and soc. risks in accordance with the amended ESIA procl. (Percentage)	
Jun/2024	Jun/2027
0	40

ANNEX 2: LETTER OF DEVELOPMENT POLICY

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The Prime Minister of the Federal Democratic Republic of Ethiopia

11 July 2024

Excellency and Dear Brother,

Please accept my warm greetings.

I am honored to express my profound appreciation for your leadership and my gratitude for the existing strong partnership between Ethiopia and the World Bank. Allow me to reiterate our commitment and readiness to further consolidate our partnership.

I am writing to provide you an update on the historic economic transformation underway as part of the Government's Home-Grown Economic Reform Agenda (HGERA). Kindly find attached an update outlining our policy commitments focused on transformative changes accomplished via the reform and what will follow over the next few years.

As you can see from this note, we are preparing to launch an aggressive reform program to make up for lost time due to recent shocks. It should be clear that we are impatient for change. Our administration has made an active decision; now is the time to move forward boldly and rapidly to enhance our people's lives. While this is our own agenda, it will require significant knowledge and financial assistance from the World Bank and other development partners. We are grateful for the World Bank's sizable support in recent years, as well as the strong partnership we forged together. We hope that our partnership will now enter a new and transformative phase under this Development Policy Operation and subsequent ones in the future years. This is a partnership that is bound in common purpose to improve the lives of our communities, enhance shared prosperity, and ensure that Ethiopia can boldly confront the new challenges posed by climate change.

Thank you for the opportunity to update you on our reform agenda. I look forward to a close and continued partnership with you and your team as we finalize this operation and look ahead to implementing a strong and effective reform agenda.

Please accept, Excellency, the assurances of my highest consideration.

Abiy Ahmed Ali (PhD)
Prime Minister of the Federal Democratic Republic of Ethiopia

H.E. Mr. Ajay Banga
President of the World Bank
Washington D.C.

Updates on Federal Democratic Republic of Ethiopia's Homegrown Economic Reform Agenda (HGERA)

1. Overview

Since 2019, our focus through the Homegrown Economic Reform Agenda (HGERA) has been correcting macro-economic imbalances, diversifying the sources of growth, rebalancing the role of public and private sector in the economy and ensuring quality and sustainable growth. Significant progress was made in the first years, but the onset of several (and simultaneous) shocks slowed Ethiopia's progress and created difficult conditions for reforms. Even so, the government persevered with reforms during this period through important reforms such as reducing gasoline subsidies and transforming state-owned enterprise (SOE) governance and operations under the Ethiopian Investment Holdings. In recent months, as external and domestic shocks have eased, the government has renewed its pledge to transform the Ethiopian economy. Ethiopia is on the cusp of historic economic changes that will transform and reshape the economy.

2. Macroeconomic reforms

Our most important and immediate economic policy priorities are reducing macroeconomic imbalances and restoring macroeconomic stability. Our ambitious goals in the HGERA cannot be achieved otherwise. With support from the World Bank and the IMF, we will swiftly and comprehensively address the root causes of Ethiopia's external and domestic macroeconomic imbalances. The shift to a market-determined exchange rate is the most fundamental of these measures and is an essential prerequisite for reviving economic performance. Following the initial phase of exchange rate reform, we will enact additional measures, as quickly as possible, to fully liberalize current account transactions, and ease other regulatory constraints that inhibit the formation of a competitive and efficient foreign exchange market. We commit to conduct continuous monitoring of FX liquidity jointly with the IMF and the World Bank and commit to remove mandatory foreign exchange surrender requirements and lift time limits on foreign exchange retention expeditiously.

We will support these reforms with an appropriate fiscal and monetary policy framework. We will cease monetary budget financing through strict fiscal provisions; move rapidly to an interest-rate-based monetary policy framework; and adopt a fiscal strategy that prioritizes aggregate spending and debt discipline, the revival of pro-poor and social spending, and higher domestic revenues. We will also work quickly and collaboratively with official and private creditors to secure meaningful debt relief that supports macroeconomic stability and helps sustain an inclusive development agenda.

3. Fiscal policy

We want to create more fiscal space to finance development. Over the last decade, fiscal space has steadily declined in real terms due to weakening tax revenue collections and declining development assistance. This has had a real impact on service delivery and the competitiveness of public sector wages. We will create fiscal space by improving spending impact and efficiency and increasing domestic tax collections. We aim to raise domestic revenue collections by at least 4 percentage points of GDP through new taxes (excise and real estate property taxes) and by improving collections of existing taxes such as value added and income taxes. We are also committed to reducing tax expenditures by reviewing and rationalizing existing tax holidays and tax expenditures available to the private sector and to SOEs. We are also committed to reforming corporate (including presumptive) taxes and rationalizing the personal income tax framework. These commitments form part of a new Medium Term Revenue Strategy that will be finalized this year.

Additional fiscal space will be used to revive spending on essential services and buffer the poor from shocks that could emerge from macroeconomic reforms. In the short term, about 1.5 percent of GDP will help reduce the poverty and social impact of the exchange rate reforms. Resources will be used to expand safety nets, slow the pace of fuel and fertilizer price convergence to new import cost recovery levels, and provide direct, temporary subsidies on certain food items and essential medicines that we will phase out entirely by June 2025. Additional fiscal space will also be used to help accelerate the reconstruction of damaged assets through our Resilient Recovery and Reconstruction framework to address reconstruction needs in conflict-affected areas of the country.

As you may be aware, the real value of public sector salaries has declined sharply in recent years, and several salary scales are below or close to the poverty line. As part of broader reforms to strengthen public sector performance, we are committed to updating the civil servant salary scale, which was established in 2011 and which needs of revision and modernization. As fiscal space becomes available, we will adjust the base pay of public service workers for inflation.

4. Financial Sector

We want to strengthen the financial sector's stability and increase financial intermediation. Following the approval by Council of Minister, two laws have been submitted to Parliament to modernize the legal frameworks governing the central bank and the commercial banking sector. The amended National Bank of Ethiopia (NBE) Establishment Proclamation clarifies the central bank's mandate and policy toolkit and provides greater autonomy for the institution to achieve its monetary policy and financial stability objectives, including through the appointment of competent non-executive directors, and enhanced measures to avoid any conflicts of interest by the board members and monetary policy committee members of the NBE. The newly enacted Banking Business Proclamation will bring Ethiopia's banking legal frameworks into greater compliance with international standards and create a legal foundation for opening the sector to foreign investment. Alongside these new laws, a range of new regulations and directives will help implement the law's provisions and strengthen the financial sector's oversight and management.

We are committed to transforming the Commercial Bank of Ethiopia (CBE) into a financially sustainable commercial entity. First, the government will replace all CBE claims on the Liabilities and Asset Management Company (LAMC) with government securities. Additional government securities will also be issued to allow CBE to provision all its claims on Ethiopia Electric Power and ensure that the bank meets minimum capital adequacy regulatory requirements. The interest rates on these securities will be set at 9 percent in the first year, 10 percent in the second year, and 10.5 percent in the third year.

We are committed to ensuring that CBE is effectively governed and supervised by NBE and can operate on commercial terms. To achieve this, we will adopt an ownership policy grounded in sound commercial practices, good corporate governance, and competitive neutrality. This policy will guide the relationship between the state and CBE and mandate the appointment of independent and competent directors to its board. CBE will operate on commercial grounds based on market principles and will set up financing mechanisms for public sector projects that are only viable and will ensure financial inclusion of remote and marginalized communities. CBE will compete in the banking industry on equal terms.

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These measures will help reduce financial system risks, increase the liquidity and financial viability of the banking sector, and create solid foundations for greater competition and investor entry. They will also help spark more private-sector access to finance. Over the coming years, the government intends to end mandatory requirements for banks to purchase government bonds and shift to relying on market-based methods to source domestic budget financing. These measures will be complemented by broader financial sector reforms to deepen capital markets and enable secondary trading of financial instruments. This builds on the recent establishment of the Ethiopian Capital Market Authority (ECMA) and the Ethiopian Securities Exchange (ESX).

5. Electricity sector

We want Ethiopia's electricity sector to provide adequate and reliable electricity service to all in a financially sustainable manner. Access to energy remains out of reach for millions, and the lack of access to reliable energy is a significant constraint to private sector growth. We cannot address these challenges without improving the sector's financial viability and sustainability. We are committed to ensuring that the sector will be able to fully and transparently fund its operations, maintenance, depreciation, debt service, and new investment needs in the long term. As a starting measure, a new tariff plan has been approved to start bringing electricity tariffs in line with cost recovery levels by 2028. As these tariff increases are implemented, the government commits to periodically evaluating and adjusting electricity tariffs to determine whether additional adjustments are needed to account for changing macroeconomic conditions and costs so as to ensure recovery of power sector's operational and debt-related costs by 2027. Measures to increase tariffs will be accompanied by broader reforms to strengthen financial viability in the sector. A new financial viability action plan will identify ways to reduce costs and sector losses, while strengthening institutional structure and governance. We are also committed to ensuring that EEP and EEU are commercially viable and will operate on commercial terms. Both entities will establish mechanisms to fulfill their respective public service obligations supported through national budget. Over time, we are also committed to increasing private sector investment in the sector and enacting necessary supportive legal and regulatory measures to help achieve this commitment.

6. Trading and business environment

We want to spark faster private sector growth and development. This is a core pillar of the HGERA and our policy engagements with the World Bank. We recognize that many systemic and structural reform measures are needed to create a level playing field, remove regulatory barriers and restrictions, and make investing in Ethiopia easier for the private sector (domestic and foreign). In the next few years, and with support from the World Bank and other development partners, we are dedicated to implementing these enhancements by refining the competition and investment legal framework, advancing reforms in the logistics sector, optimizing tax and customs administrations, and simplifying export and import regulations and customs procedures to minimize unnecessary bureaucracy and reduce red tape. We have begun these efforts by removing export bans on maize, sorghum, and barley, which will help expand markets, improve trading options, and eventually increase incomes for rural farmers, some of whom are among the poorest people in the country. Removing these bans is unlikely to have a major impact on Ethiopia's food security, but instead, it will create stronger incentives for higher domestic cereal production. We are committed to further reviewing and removing similar restrictions that limit export opportunities, especially in the agricultural sector, where the benefits of shifting to market exchange rates could generate quick wins through higher farm incomes.

We are also accelerating our efforts to integrate Ethiopia's economy with regional and global trading systems. The government is committed to timely implementation of the African Continental Free Trade Agreement and accelerating Ethiopia's accession to the World Trade Organization. These efforts will be backed by the continued commitment of the government to expand and improve infrastructure to improve connectivity and foster a conducive environment that facilitates trade and private investment.

7. Public Financial Management and State-Owned Enterprises

We want to strengthen public financial management and the performance and oversight of SOEs. The first phase of reforms will focus on increasing the financial transparency of public sector spending by reducing quasi-fiscal deficits in CBE and the energy sector and improving the quality and timeliness of SOE and public sector financial reporting. Over the next few years, we will also roll out a new Public Service Obligation framework that will provide budgetary compensation to public entities when directed to execute developmental projects at below-cost recovery levels.

These measures complement existing efforts by Ethiopia Investment Holdings and the Public Enterprise Holding and Administration to strengthen SOE oversight, corporate governance, and financial management. They also complement new legislation, supported by the World Bank's Sustainable Development Financing Policy, that oversees the governance of SOEs and creates legal foundations for a level playing field that allows for fair competition between state and private sector entities. To help implement enhanced fiscal risk management requirements in the new legislation, the Ministry of Finance will reinforce the oversight and risk monitoring of SOEs. Finally, to strengthen the quality of professional standards in the accounting and audit profession, we are also committed to advancing legislation and regulations to establish an institute for certified public accountants.

The government is also committed to renewing privatization efforts after a few years of difficult investment conditions. Over the next year, we will relaunch processes to partially privatize Ethio Telecom, attract a second private telecommunications provider, and privatize nine sugar estates.

8. Social Safety Nets

We want more protection for the poor and vulnerable from shocks. As seen in recent years, pro-poor initiatives are part of a solid and comprehensive program designed to uplift disadvantaged communities and ensure equitable access to essential services. These initiatives include school feeding programs that provide nutritious meals to close to 8 million children, enhancing their learning capabilities and overall health. Additionally, ongoing extensive urban house renovation projects aim to improve living conditions for low-income families, fostering a safer and more conducive environment for growth and development. Through these initiatives and by integrating them into a cohesive framework, we are addressing multiple dimensions of poverty simultaneously, ensuring that the benefits are sustainable and far-reaching. This holistic approach underscores our commitment to creating inclusive opportunities and improving the quality of life for the most vulnerable populations. This is a testament that we are equally committed to supporting and empowering poor households to participate and thrive in the economy.

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As you are aware. Ethiopia hosts one of the largest safety net programs in Sub-Saharan Africa. And as we move forward with bold reforms to reorient the economy and restore macroeconomic stability, our rural and urban safety net programs, which are funded in partnership with development partners, provide a strong platform for us to help alleviate the poverty and social impact of economic reforms. Our first and most bold measure to strengthen these systems is to significantly increase the government's share of financing for these programs, from about 0.1 to 0.4 percent of GDP, beginning in Ethiopian fiscal year 2017 (Gregorian 2024/25). Our intention is to help create livelihoods and build resilience making the programs more productive. Noting that thus far, a substantial amount of financing for both programs was provided by development partners, we commit to reduce and gradually eliminate donor reliance for this project. The envisaged budget increase will also be sufficient to increase benefit levels for all existing beneficiaries in line with expected inflationary impacts from the macroeconomic adjustment, and to support a gradual increase in the number of core program beneficiaries. Development partner financing will still play a critical role by supporting substantial temporary expansions of the rural and urban programs to support poorer households in response to macroeconomic shocks, and to also support our goal of expanding the number of core program beneficiaries over the medium term.

These measures will be complemented by the broader fiscal program of supportive measures that I outlined earlier in this letter. We are also committed to transforming and modernizing the safety net system. This will include reforms to strengthen the targeting and effectiveness of the program by bringing it in line with good international practice.

The transformation of the social protection systems will also leverage key developments in the payment and digital ecosystem. This includes the National Bank of Ethiopia Payment Instrument Issuer Directive for mobile money providers which was revised in October 2023 that facilitated the entry of the first foreign-based mobile money provider, M-PESA, into the Ethiopian market. As a result, the number of mobile money payment providers is expected to increase, offering social protection programs more options for cash benefit delivery at competitive prices and with improved efficiency and better financial inclusion results. In addition, in November 2023 Memorandums of Understanding (MoUs) were established to provide a framework for integrating Ethiopia's Digital ID (*Fayda* ID) with the urban and rural safety net programs. The MoUs lay the foundation for using *Fayda* as the primary method of beneficiary identification in the safety nets, which will contribute towards streamlining of beneficiary identification, facilitating complementarity of support packages and the deployment of interoperable systems for efficient program management.

9. More inclusive and resilient growth

We want growth to benefit more people. We are committed to expanding economic opportunities for all Ethiopians everywhere in the country, and especially for groups that are under benefitted, such as women, youth, and disabled persons. A first step towards addressing constraints to greater domestic labor mobility and economic participation is the launch of Fayda, Ethiopia's new national digital ID system. We are ambitiously expanding Fayda registrations across the country. Fayda will open many possibilities to simplify life for our citizens by delivering more efficient physical and digital government services. It will also pave the way for better management of existing programs such as safety nets and active labor market programs. It will also help reduce fraud, corruption, and tax evasion, and help ensure that everyone is contributing fairly to the country's development. We will continue to accelerate our rollout of Fayda, while also ensuring that our citizens can have confidence that the system is safe and protective of their personal data and information. With support from the World Bank, we will also move

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The Federal Democratic Republic of Ethiopia
Office of the Prime Minister

ahead with broader public sector reform measures to digitize public sector operations, increase the availability of electronic government services, and increase competition for the delivery of ICT services to public institutions. We are committed to ensuring that all these services will be offered on a level playing field that does not favor any one platform or provider and allows for a strong, collaborative, and productive partnership between the government and private sector.

As we expand economic opportunities for more Ethiopians, we want these opportunities to come from more resilient and sustainable sources, and for the economy to be more resilient to shocks and a changing climate. Ethiopia has made tremendous progress with land registration in the rural highlands, with more than 25 million geo-referenced digital "second level" certificates issued since 2013 alone. In recent years, as land registration and certification has accelerated in the highlands, there has been a 65 percent drop in land disputes and increasing uptake of micro-finance. We are committed to making rural land certificates available nationwide. This will help increase opportunities for poorer farmers, give them greater security to invest in more productive agriculture, and create incentives for them to use more environmentally resilient and friendly practices. Over the medium term, the government will continue to prioritize land reforms as an integral part of the overall reform agenda to increase the efficiency and availability of factor inputs for households and firms in Ethiopia. In addition, we will continue to identify opportunities to expand rural access to domestic and international agricultural markets, while also removing legal and regulatory impediments that make it more difficult for agricultural market development. We will also continue to strengthen our institutional frameworks to encourage more resilient economic growth and public investment, including through the rollout of enhanced processes for environmental and social impact assessments for public and private sector projects.

10. Improving data and statistics

We need better information to make better policy decisions. Alongside measures to improve the transparency of public sector financial information, we are also committed to improving the quality of official statistics. Our most immediate priority will be to strengthen the quality of national accounts and fiscal statistics and to ensure that information is prepared and published regularly. We are also committed to rebasing our national accounts over the medium term to reflect changes to Ethiopia's economic context in recent years. We will also work closely with the World Bank and other partners to improve the quality of household demographic, consumption, labor market, and health data. At a sector level, we also remain committed to improving the quality of data to help guide more effective planning, budgeting, and monitoring of outcomes.

ANNEX 3: ENVIRONMENT AND POVERTY/SOCIAL ANALYSIS TABLE

Prior Actions	Significant positive or negative environment effects	Significant poverty, social or distributional effects positive or negative
Operation Pillar 1: Advance financial sector restructuring and trade liberalization		
FINANCIAL STABILITY AND INTERMEDIATION **Prior Action 1:** To strengthen the central bank's oversight of the banking sector, the Council of Ministers (COM) has submitted to Parliament amendments to the Establishment Proclamation for the National Bank of Ethiopia enhancing the independence of the NBE and its mandate to promote financial stability.	Neutral	Neutral
Prior Action 2: To strengthen financial stability and intermediation, (a) the COM has submitted to Parliament the draft Banking Business Proclamation; (b) the NBE has issued five directives that strengthen regulations for (i) asset classification and provisioning; (ii) related party transactions; (iii) large exposures; (iv) fit and proper requirements for bank boards; and (v) corporate governance and (c) the COM has adopted a Reform, Restructuring and Recapitalization Plan for Commercial Bank of Ethiopia (CBE).	Neutral	Neutral
TRADE INTERMEDIATION **Prior Action 3:** To support agricultural exports, the Ministry of Trade and Regional Integration, has: (a) issued two directives lifting export bans on maize and sorghum, and on barley;	Neutral in the short term. Indirect negative impacts in the longer term if increased investments in cereal production increase fertilizer use.	Neutral in the short term. Positive in the medium term if it enhances the market orientation of rural producers and increases marketable surplus for domestic and export use.

and (b) submitted a tariff offer to the AfCFTA aligning tariffs on trade in goods to AfCFTA standards.		
Operation Pillar 2: Promote Fiscal Transparency and Sustainability		
REVENUE MOBILIZATION **Prior Action 4:** To increase revenues from the value-added tax (VAT), the COM has submitted to Parliament amendments to the VAT Proclamation that: (a) reduce the number of items exempted for VAT; (b) limit the zero-rating for VAT purposes to only exported and re-exported items; (c) permit voluntary VAT registration by currently exempted businesses; and (d) grants exclusive authority to the Federal Government to collect the VAT.	Neutral. Potentially positive impacts if removal of exemptions, especially on transport services (e.g., non-Electric Vehicle (EV) ridesharing transport services that have increased significantly in recent years) reduce pollution.	The ending of VAT exemptions for electricity (except for the lifeline block) will have small negative effect on households' welfare for those connected to the grid.[41] Essential food items, notably cereals[42], injera, bread, and milk also remain exempt from VAT, as are key agricultural inputs.[43]
Prior Action 5: To support more efficient, transparent, and sustainable procurement, the Recipient has enacted the Federal Public Procurement and Property Administration Proclamation mandating the use of e-procurement and the incorporation of green procurement principles.	Positive if reduced vehicular trips and greater use of e-procurement reduce pollution. The amended law's focus on sustainable and green procurement will require procurement decisions to account for environmental and climate-related costs for the full life-cycle of procured goods, from acquisition to disposal, which will lessen environmental impact of public procurement over time.	Neutral

[41] 46 percent of the population currently do not have access to electricity services
[42] Including teff, barley, wheat, maize, sorghum, millet, oats, peas, beans, lentils, chickpeas and more.
[43] These include fertilizer, pesticides, seeds, and veterinary medicines.

PUBLIC SECTOR TRANSPARENCY **Prior Action 6:** To increase the transparency of state-owned enterprises, (a) Ethiopia Electric Power, Ethiopia Electric Utility, Ethio Telecom, Ethiopian Agricultural Business Corporation, and Ethiopian Petroleum Supply Enterprise have published audited financial statements for 2021/22; and (b) the Ethiopia Investment Holdings and the Public Enterprise Holding and Administration have issued directives mandating state-owned enterprises under these institutions to prepare and publish audited financial statements on an annual basis effective from the next fiscal year.	No. The inclusion of Ethiopian Petroleum Supply Enterprise in this measure is intended to improve the governance of fuel procurement in Ethiopia, as the company is responsible for 100 percent of national fuel imports. Inefficiencies in fuel procurement contribute to significant disruptions in fuel supply chains that lead to regular and lengthy queues for fuel that contribute to additional greenhouse gas emissions.	Neutral in the short term. Positive in the medium to long term (via the employment, income, and productivity channels) if PA levels the playing field across SOE and firms and reduces product market distortions.
PA7: ENERGY SUPPLY **Prior Action 7:** To strengthen the financial sustainability of the energy sector, (a) the Ministry of Finance has issued a Directive replacing 100 percent of outstanding debt obligations from the Ethiopia Electric Power owed to the Commercial Bank of Ethiopia as of May 2024; and (b) the COM has adopted a 4-year electricity tariff adjustment, raising end-user tariffs by at least 10 percent each quarter for the first year, with the objective to move toward full recovery of operational and debt service costs for the electricity sector by 2028.	Neutral to positive	There is expected to be a small negative impact on the poor. Although electricity tariff reform will negatively impact the poor, welfare costs are expected to be more prominent among wealthier and urban households (i.e., equivalent to 0.7 percent of household expenditure for the wealthiest quintile versus 0.38 for the poorest quintile). Ethiopia's poor have limited access to the public electric grid, and the social tariff scheme will reduce the burden on those who do.
Operation Pillar 3: Enhance Social Resilience and Climate Action		

EXPANSION OF SOCIAL SAFETY NETS **Prior Action 8:** To better protect the poor and improve the management of safety nets, (a) the Recipient has committed to increase the number of beneficiaries and the benefits paid per beneficiary in both the rural and urban Productive Safety Nets Programs; and (b) the Recipient's Parliament has approved the Personal Data Protection Proclamation establishing the legal framework to protect and secure personal administrative data.	Positive impact due to public works components of both urban and rural safety net programs that currently include watershed and rangeland rehabilitation, terracing, waste management in urban areas, tree-planting, and reduced land degradation.	Positive impact on beneficiary households.
LAND AND FOREST MANAGEMENT **Prior Action 9:** To support sustainable land and forest management, build resilience for rural and forest communities, and reduce carbon emissions, (a) the Recipient's Parliament has approved the Rural Land Administration and Use Proclamation establishing rural land property rights; and (b) the COM has issued regulations for forest management creating a legal basis for the sale of emissions reduction.	Sustainable forest management is expected to generate potentially positive environmental benefits over the medium to long term, especially if it reduces pace of deforestation.	Potential positive effect on rural incomes in the medium to long term due to better land management. Potential positive effect for households that depend on forestry for their livelihoods.
CLIMATE ACTION **Prior Action 10:** To strengthen the management of environmental and social risks, the COM has submitted to Parliament amendments to the Environmental Impact Assessment (EIA) Proclamation establishing enhanced mechanisms and procedures for environmental and social impact assessments in investment projects.	Positive impact. Amendments to the EIA law enable revocation of powers relating to the administration of environmental and social impact assessments (ESIAs) from six sector line ministries back to Environmental Protection Agency (EPA); renewed emphasis on social impact assessment and climate change risk assessment in ESIA; and stronger emphasis on public consultation. The amendments provide the legal basis to strengthen the ESIA system.	Neutral

ANNEX 4: ANALYTICAL UNDERPINNINGS

Prior Actions	Analytical Underpinnings
Pillar 1: Advance financial sector restructuring and trade liberalization	
PA1	Ethiopia SCD (2024); CEM (2022); Technical Notes under FSSP (2024).
PA2	Technical Notes under FSSP (2024).
PA3	CEM (2022); SCD (2024); Additional Financing Paper Trade and Logistics Project (2023); Technical Note on the AfCFTA (2023); Rural Income Diagnostic (2023).
Pillar 2: Promote fiscal transparency and sustainability	
PA4	Public Finance Review (forthcoming); FCDO and IMF TA on tax policy (2024).
PA5	Ethiopia MAPS (2024); Public Finance Review(forthcoming).
PA6	World Bank Technical Notes (2023-2024); Public Finance Review (forthcoming).
PA7	World Bank Technical Notes on EEP/EEU financial statements and tariff setting (2024).
Pillar 3: Enhance social resilience and climate action	
PA8	Public Finance Review (forthcoming); SCD (2024); Ethiopia CCDR (2024).
PA9	Ethiopia CCDR (2024). Ethiopia Rural Income Diagnostic (2023)
PA10	Ethiopia CCDR (2024).

ANNEX 5: PARIS ALIGNMENT ASSESSMENT

<table>
<tr><td colspan="2">Program Development Objectives: To support the Government of Ethiopia's efforts to: (i) advance financial sector restructuring and trade liberalization; (ii) promote fiscal transparency and sustainability; and (iii) enhance social resilience and climate action</td></tr>
<tr><td>Step 1: Is the operation consistent with Ethiopia’s climate commitments and relevant strategies, as well as the CCDR?</td><td>Yes. The operation is aligned with Ethiopia’s low-carbon trajectory and mitigation targets as articulated in its 2021 NDC. It is also consistent with key national and sectoral strategies, including the 2011 Climate Resilient Green Economy (CRGE) strategy that identified agriculture, deforestation, energy, and transport sectors as priority sectors for climate action and that was then mainstreamed in the 2019 Green Legacy Initiative (that sought to restore degraded lands, increase forest cover, and reduce the impact of climate change), the updated 2021 NDC, and the 2023 Long-Term Low Emissions Development Strategy (LT-LEDS). The updated NDC proposed an emissions reduction target of 68.8 percent, as compared to 64 percent proposed in the first NDC, and specific mitigation interventions, including in land use and land change (identifying sustainable land management, reforestation and land restoration as key mitigation AND adaptation interventions), energy; and sustainable forest management and utilization of forest resources. It operationalizes several recommendations of the Ethiopia CCDR (March 2024), including supporting increased financial intermediation and trade (including the lifting of bans on cereals), increasing domestic revenue mobilization, strengthening cost recovery of the energy sector, incorporating climate considerations into public procurement and investment, building climate resilience through expansion, strengthening of social safety net programs, and improving land and forest management.</td></tr>
<tr><td colspan="2">Mitigation goals: assessing and reducing risks</td></tr>
<tr><td colspan="2">Pillar 1: Advance financial sector restructuring and trade liberalization</td></tr>
<tr><td colspan="2">Prior Action 1: To strengthen the central bank’s oversight of the banking sector, the Council of Ministers (COM) has submitted to Parliament amendments to the Establishment Proclamation for the National Bank of Ethiopia enhancing the independence of the NBE and its mandate to promote financial stability.</td></tr>
<tr><td>Step M2.1: Is the prior action likely to cause a significant increase in GHG emissions?</td><td>No. This PA supports strengthened supervision of the banking sector, which is not expected to increase emissions.</td></tr>
<tr><td>Conclusion of Prior Action 1:</td><td>PA1 is Paris Aligned.</td></tr>
<tr><td colspan="2">Prior Action 2: To strengthen financial stability and intermediation, (a) the COM has submitted to Parliament the draft Banking Business Proclamation; (b) the NBE has issued five directives that strengthen regulations for (i) asset classification and provisioning; (ii) related party transactions; (iii) large exposures; (iv) fit and proper requirements for bank boards; and (v) corporate governance and (c) the COM has adopted a Reform, Restructuring and Recapitalization Plan for Commercial Bank of Ethiopia (CBE).</td></tr>
</table>

Step M2.1: Is the prior action likely to cause a significant increase in GHG emissions?	**No.** The prior action supports the reform and restructuring of the systemically important CBE and helps support financial stability through the enactment of banking legislation and several Directives to strengthen corporate governance and management of risks. Over the long term, the reform is expected to improve financial intermediation; while this may lead to an increase in emissions as increased credit flow expands private sector activity, it would also indirectly increase finance available for climate-friendly projects. As a result, this is expected to have a neutral impact on GHG emissions.
Conclusion of Prior Action 2:	PA2 is Paris Aligned.
Prior Action 3: To support agricultural exports, the Ministry of Trade and Regional Integration, has: (a) issued two directives lifting export bans on maize and sorghum, and barley and (b) submitted a tariff offer to the AfCFTA aligning tariffs on trade in goods to AfCFTA standards.	
Step M2.1: Is the prior action likely to cause a significant increase in GHG emissions?	**No.** This measure helps address Ethiopia's climate risks by supporting greater trade integration that allows Ethiopia to more easily access global supply chains to mitigate supply shortages triggered by climatic events such as droughts. The tariff offer also includes lower import tariffs on goods that contribute to climate change risk mitigation (e.g., clean and renewable energy infrastructure such as solar panels and more energy efficient capital) and adaptation (e.g., agricultural seed varieties and irrigation components).
Conclusion of Prior Action 3:	PA3 is Paris Aligned.
Pillar 2: Promote fiscal transparency and sustainability	
Prior Action 4: To increase revenues from the value-added tax (VAT), the COM has submitted to Parliament amendments to the VAT Proclamation that: (a) reduce the number of items exempted for VAT; (b) limit the zero-rating for VAT purposes to only exported and re-exported items; (c) permit voluntary VAT registration by currently exempted businesses; and (d) grants exclusive authority to the Federal Government to collect the VAT.	
Step M2.1: Is the prior action likely to cause a significant increase in GHG emissions?	No. The new VAT Proclamation, which maintains a uniform 15 percent tax rate, strengthens the exemptions regime. Exemptions to be removed under the new VAT regime include transportation services (excluding public transportation), e-commerce, financial, and utilities (water and electricity with consideration for low-income and vulnerable groups). This removal of exemptions, especially on transport services (e.g., non-EV ridesharing transport services that have increased significantly in recent years) and utilities, generates climate co-benefits and is aligned with 2021 NDC priorities to "(reduce) the demand for petroleum" and to "target energy consumed by all sectors."
Conclusion of Prior Action 4:	PA4 is Paris Aligned.
Prior Action 5: To support more efficient, transparent, and sustainable procurement, the Recipient's Parliament has approved the Federal Public Procurement and Property Administration Proclamation mandating the use of e-procurement and the incorporation of green procurement principles	

Step M2.1: Is the prior action likely to cause a significant increase in GHG emissions?	**No.** The prior action supports sustainable procurement, green procurement, and e-procurement all of which support emissions reductions. The amended law's focus on green procurement will require procurement decisions to account for environmental and climate-related costs for the full life-cycle of procured goods, from acquisition to disposal. This is likely to support climate change risk adaptation through the procurement of more climate-resilient goods, and mitigation through the procurement of goods with lower environmental impact over the full life cycle of use. The law encourages public and private sector climate action through a greater share of non-common-use procurement mandated to consider environmental and climate-related costs. This is likely to support lower emissions. Further emissions reductions are also likely through the digitization of public procurement procedures, resulting in lower material use and travel costs for vendors to and from government buildings for the submission of bids. More importantly, the digitization of procurement will be an important first step towards increasing digitization of other areas of public administration, which reduces paper flows.
Conclusion of Prior Action 5:	PA5 is Paris Aligned.
Prior Action 6: To increase the transparency of state-owned enterprises, (a) Ethiopian Electric Power, Ethiopian Electric Utility, Ethio Telecom, Ethiopian Agricultural Business Corporation, and Ethiopian Petroleum Supply Enterprise have published audited financial statements for 2021/22; and (b) the Ethiopian Investment Holdings and the Public Enterprise Holding and Administration have issued directives mandating state-owned enterprises under these institutions to prepare and publish audited financial statements on an annual basis effective from the next fiscal year.	
Step M2.1: Is the prior action likely to cause a significant increase in GHG emissions?	**No.** The inclusion of Ethiopian Petroleum Supply Enterprise in this measure is intended to improve the governance of fuel procurement in Ethiopia, as the company is responsible for 100 percent of national fuel imports. Inefficiencies in fuel procurement contribute to significant disruptions in fuel supply chains that lead to regular and lengthy queues for fuel which contribute to additional greenhouse gas emissions. Financial inefficiencies also contribute to higher logistical costs for fuel imports, requiring larger petroleum pump subsidies and making the removal of those subsidies more socially and politically difficult. The first step towards addressing these inefficiencies and reducing their contributions to climate change is to improve the financial transparency of Ethiopia's petroleum procurement system. As part of the broader reform agenda in the

	program, the government is committed to making fuel procurement more effective and efficient, with emphasis on reducing logistics costs and improving supply chain efficiency and reliability.
Conclusion of Prior Action 6:	PA6 is Paris Aligned.
Prior Action 7: To strengthen the financial sustainability of the energy sector, (a) the Ministry of Finance has issued a Directive replacing 100 percent of outstanding debt obligations from the Ethiopia Electric Power owed to the Commercial Bank of Ethiopia as of May 2024; and (b) the COM has adopted a 4-year electricity tariff adjustment, raising end-user tariffs by at least 10 percent each quarter for the first year, with the objective to move toward full recovery of operational and debt service costs for the electricity sector by 2028..	
Step M2.1: Is the prior action likely to cause a significant increase in GHG emissions?	**No.** The electricity tariff increase will encourage more optimal energy use and thus support emission reductions. Improving the financial sustainability of the energy sector will help support future public-private partnerships, especially in the renewables sector in Ethiopia.
Conclusion of Prior Action 7:	PA7 is Paris Aligned.
Pillar 3: Enhance social resilience and climate action	
Prior Action 8: To better protect the poor and improve the management of safety nets, (a) the Recipient has committed to increase the number of beneficiaries and the benefits paid per beneficiary in both the rural and urban Productive Safety Nets Programs; and (b) the Recipient's Parliament has approved the Personal Data Protection Proclamation establishing the legal framework to protect and secure personal administrative data	
Step M2.1: Is the prior action likely to cause a significant increase in GHG emissions?	**No.** The expansion of the safety net programs will facilitate emissions reductions through the public works components of both urban and rural safety net programs that currently include watershed and rangeland rehabilitation, terracing, waste management in urban areas, tree-planting, and reduced land degradation—all of which are key sources of emissions in Ethiopia, as detailed in the CCDR. Land restoration and tree planting are explicit mitigation interventions identified in the updated NDC, which identified these as having significant net emissions removal potential, along with sustainable land management (see link here to NDC). Documented evidence of climate emissions reductions related to safety net linked public works includes a 3.8 percent increase in tree coverage (between 2005 and 2019) resulting in increased carbon sequestration. (see Dawit et. al., 2014, Ethiopia's Productive Safety Net Program (PSNP): Soil carbon and fertility impact assessment.). Other evidence is documented in the CCDR (2024).
Conclusion of Prior Action 8:	PA8 is Paris Aligned.
Prior Action 9: To support sustainable land and forest management, build resilience for rural and forest communities, and reduce carbon emissions, (a) the Recipient's Parliament has approved the Rural Land Administration and Use Proclamation establishing rural land property rights; and (b) the COM has issued regulations for forest management creating a legal basis for the sale of emissions reduction.	
Step M2.1: Is the prior action likely to cause a significant increase in GHG emissions?	**No.** Almost 90 percent of emissions In Ethiopia are related to agriculture land use change and forestry. The prior action supporting

	sustainable land and forest management is expected to produce significant mitigation co-benefits. It is directly linked to the 2021 NDC which identified: (i) increasing the share of agricultural land under sustainable land management practices; (ii) restoration of 3 million ha of land by 2030; and (iii) restoration of 5 million ha of land by 2030 as explicit interventions to reduce emissions. The highest carbon storage and sequestration rates are seen in the forested regions in the southwest and south-central areas of the country, covering parts of Gambella, Oromia, and the Southern Nations, Nationalities, and Peoples' (SNNPR) regions. Since these areas are also those estimated to have among the highest land use change and forestry (LUCF) emissions rates, investing in land restoration and management in these locations will yield carbon credits. Per the 2021 NDC, the livestock sector exhibits the second most important mitigation abatements and is also viewed as one of the most important contributors to emission source. Therefore, productivity improvements in the livestock sector would decrease GHG emission intensity factors.
Conclusion of Prior Action 9:	PA9 is Paris Aligned.
Prior Action 10: To strengthen the management of environmental and social risks, the COM has submitted to Parliament amendments to the Environmental Impact Assessment Proclamation establishing enhanced mechanisms and procedures for environmental and social impact assessments in investment projects.	
Step M2.1: Is the prior action likely to cause a significant increase in GHG emissions?	**No.** The action supports the incorporation of climate change considerations, including emissions reductions, into public investment projects.
Conclusion of Prior Action 10:	PA10 is Paris Aligned.
Mitigation Goals: Conclusion of the Paris Alignment Assessment for the operation: Paris Aligned.	
Adaptation and resilience goals: assessing and managing the risks	
Pillar 1: Advance financial sector restructuring and trade liberalization	
Prior Action 1: To strengthen the central bank's oversight of the banking sector, the Council of Ministers (COM) has submitted to Parliament amendments to the Establishment Proclamation for the National Bank of Ethiopia enhancing the independence of the NBE and its mandate to promote financial stability.	
Step A2: Are risks from climate hazards likely to have an adverse effect on the prior action's contribution to the Development Objective(s)?	**No.** Climate hazards are not expected to adversely impact improvements in banking sector supervision and related improvements in financial sector stability.
Conclusion of Prior Action 1:	PA1 is Paris Aligned
Prior Action 2: To strengthen financial stability and intermediation, (a) the COM has submitted to Parliament the draft Banking Business Proclamation; (b) the NBE has issued five directives that strengthen regulations for (i) asset classification and provisioning; (ii) related party transactions; (iii) large exposures; (iv) fit and proper requirements for bank boards; and (v) corporate governance; and (c) the COM has adopted a Reform, Restructuring and Recapitalization Plan for Commercial Bank of Ethiopia (CBE).	

Step A2: Are risks from climate hazards likely to have an adverse effect on the prior action's contribution to the Development Objective(s)?	**No.**
Conclusion of Prior Action 2:	PA2 is Paris Aligned
Prior Action 3: To support agricultural exports, the Ministry of Trade and Regional Integration, has: (a) issued two directives lifting export bans on maize and sorghum, and barley; and (b) submitted a tariff offer to the AfCFTA aligning tariffs on trade in goods to AfCFTA standards.	
Step A2: Are risks from climate hazards likely to have an adverse effect on the prior actions' contribution to the Development Objective(s)?	**No.** The PA aims at expanding trade, including maize and barley exports, and would contribute positively to reducing climate risks by supporting adjustment to climate shocks (e.g., through enabling increased food imports at lower tariff rates), increasing incentives for small-holder farmers to undertake productivity-enhancing investments in cereal farming that increase surpluses that can be drawn on during drought periods. Lower tariff rates on imports will enable adaptation and resilience by enabling the import of better seed varieties (e.g., those that are more drought resistant) or irrigation and water storage infrastructure.
Conclusion of Prior Action 3:	PA3 is Paris Aligned
Pillar 2: Promote fiscal transparency and sustainability	
Prior Action 4: To increase revenues from the value-added tax (VAT), the COM has submitted to Parliament amendments to the VAT Proclamation that: (a) reduce the number of items exempted for VAT; (b) limit the zero-rating for VAT purposes to only exported and re-exported items; (c) permit voluntary VAT registration by currently exempted businesses; and (d) grants exclusive authority to the Federal Government to collect the VAT.	
Step A2: Are risks from climate hazards likely to have an adverse effect on the prior action's contribution to the Development Objective(s)?	**No**. Climate hazards are not expected to affect the outcomes of a strengthened VAT system.
Conclusion of Prior Action 4:	PA4 is Paris Aligned.
Prior Action 5: To support more efficient, transparent, and sustainable procurement, the Recipient's Parliament has approved the Federal Public Procurement and Property Administration Proclamation mandating the use of e-procurement and the incorporation of green procurement principles.	
Step A2: Are risks from climate hazards likely to have an adverse effect on the prior action's contribution to the Development Objective(s)?	**No**. Climate hazards are not expected to affect efficiency, transparency and strengthened public procurement supported by these actions.
Conclusion of Prior Action 5:	PA5 is Paris Aligned.
Prior Action 6: To increase the transparency of state-owned enterprises, (a) Ethiopian Electric Power, Ethiopian Electric Utility, Ethio Telecom, Ethiopian Agricultural Business Corporation, and Ethiopian Petroleum Supply Enterprise have published audited financial statements for 2021/22; and (b) the Ethiopian Investment Holdings and the Public Enterprise Holding and Administration have issued directives mandating state-owned enterprises under	

these institutions to prepare and publish audited financial statements on an annual basis effective from the next fiscal year.	
Step A2: Are risks from climate hazards likely to have an adverse effect on the prior action's contribution to the Development Objective(s)?	**No**.
Conclusion of Prior Action 6:	PA6 is Paris Aligned.
PA7: To strengthen the financial sustainability of the energy sector, (a) the Ministry of Finance has issued a Directive replacing 100 percent of outstanding debt obligations from the Ethiopia Electric Power owed to the Commercial Bank of Ethiopia as of May 2024; and (b) the COM has adopted a 4-year electricity tariff adjustment, raising end-user tariffs by at least 10 percent each quarter for the first year, with the objective to move toward full recovery of operational and debt service costs for the electricity sector by 2028.	
Step A2: Are risks from climate hazards likely to have an adverse effect on the prior action's contribution to the Development Objective(s)?	**No**. Improved cost recovery in the energy sector may help build resilience to climate-related disruptions to energy infrastructure assets.
Conclusion of Prior Action 7:	PA7 is Paris Aligned.
Pillar 3: Enhance social resilience and climate action	
Prior Action 8: To better protect the poor and improve the management of safety nets, (a) the Recipient has committed to increase the number of beneficiaries and benefits paid per beneficiary in both the rural and urban Productive Safety Nets Programs; and (b) the Recipient's Parliament has approved the Personal Data Protection Proclamation establishing the legal framework to protect and secure personal administrative data.	
Step A2: Are risks from climate hazards likely to have an adverse effect on the prior action's contribution to the Development Objective(s)?	**No**. The expansion of the safety net programs, in addition to supporting climate resilience, will help build climate resilience through the public works components of both urban and safety net programs that include watershed and rangeland rehabilitation, terracing, tree-planting, and reduced land degradation. All of these help reduce the risk of landslides and floods, soil erosion, and sedimentation, thus protecting social infrastructure that is subject to climate risks, such as health and school facilities. The increase in safety benefits would also support the increased resilience of beneficiaries to climate shocks. Each of these areas is identified as an adaptation priority in the 2021 NDC which calls for, and sets explicit targets for restoration and reforestation through tree planting, increased national forest coverage, watershed protection and development, and increased climate resilience of urban systems. There are ongoing investments in underlying systems to ensure adequate governance of the shock responsive safety nets and the ability to deliver timely assistance including early climate risks warning and needs assessment systems. Documented climate change resilience results of safety nets in Ethiopia include: 13 percent average increase in crop yields attributable to the PSNP

	public works program; and surface runoff reduced which has raised groundwater level.
Conclusion of Prior Action 8:	PA8 is Paris Aligned.
Prior Action 9: To support sustainable land and forest management, build resilience for rural and forest communities, and reduce carbon emissions, (a) the Recipient's Parliament has approved the Rural Land Administration and Use Proclamation establishing rural land property rights; and (b) the COM has issued regulations for forest management creating a legal basis for the sale of emissions reduction.	
Step A2: Are risks from climate hazards likely to have an adverse effect on the prior action's contribution to the Development Objective(s)?	**No**. Sustainable land and forest management are expected to increase climate resilience and reduce the climate vulnerabilities of poor rural and forest communities. Increased investments in land management, frequently financed with small loans using land certificates as collateral, often take the form of shifting to perennial tree crops which helps stabilize slopes, sequester carbon, and generate higher returns at household level. Increased investments in soil and water conservation practices, such as terracing and contour bunding also increase resilience to floods and droughts. Forestry regulations create the legal basis for defining ownership and transfer rights for forests and the Emissions Reductions (ERs) they can generate. They also create incentives for forest associations and local communities to manage forests and woodlands sustainably, thus ensuring these resources contribute to climate resilience by protecting vital ecosystem services, such as slope stabilization and soil retention. Improving the regulatory basis for forest management will help sustain forest resources as a buffer for forest-dependent communities during climate and economic shocks. Land and forest management are explicitly identified as critical adaptation priority in the 2021 NDC which calls for restoration and reforestation through tree planting, and increased national forest coverage. The NDC sets targets for increased hectares of reforested/restored land (to 9 million ha by 2030) and for increased earnings from sustainable forest products, a variant of which is captured in the result indicator for PA9 (sale of emissions reductions).
Conclusion of Prior Action 9:	PA9 is Paris Aligned.
Prior Action 10: To strengthen the management of environmental and social risks, the COM has submitted to Parliament amendments to the Environmental Impact Assessment Proclamation establishing enhanced mechanisms and procedures for environmental and social impact assessments in investment projects.	

Step A2: Are risks from climate hazards likely to have an adverse effect on the prior action's contribution to the Development Objective(s)?	**No**. Climate risks are not expected to affect the outcomes of this action. Instead, measures supported may reduce climate vulnerabilities, both of public assets and the communities and households that benefit from the public services that these assets generate. The 2021 NDC identifies the implementation of forest protection and sustainable, natural resources development, management and watershed protection, as key adaptation interventions as measured by federal/regional institutions with improved capacity to do so and PFM associations with the relevant vested legal personality. PA10 supports amendments to the EIA law that in turn (i) enable revocation of powers relating to the administration of environmental and social impact assessments (ESIAs) from six sector line ministries back to Environmental Protection Agency (EPA); (ii) renewed emphasis on social impact assessment and climate change risk assessment in ESIA; and (iii) stronger emphasis on public consultation. The amendments are critically needed to advance recognition of the EPA as a key regulatory body and to address a gap in social impact assessment; they also provide the legal basis to strengthen the ESIA system and are thus aligned with the adaptation priorities indicated in the 2021 NDC.
Conclusion of Prior Action 10:	PA10 is Paris Aligned.
Adaptation Goals: Conclusion of the Paris Alignment Assessment for the operation: Paris Aligned.	
Overall conclusion of Paris Alignment Assessment: The operation is Paris Aligned.	

ANNEX 6: TECHNICAL ASSISTANCE (TA) AND CAPACITY BUILDING TO SUPPORT IMPLEMENTATION OF REFORMS, AND MONITORING OF POVERTY AND SOCIAL IMPACTS OF REFORMS

Reform area	Enhanced technical and capacity support
1. Financial sector	The FSSP (under preparation) will support the implementation of the NBE and Banking laws, 5 NBE directives and CBE's Reform, Restructuring and Recapitalization Plan (3Rs plan) prior actions in DPO-1. The approval of the two laws will pave the way for the implementation of other banking sector reforms under FSSP that include: (i) opening of the banking sector to foreign investment; (ii) Basel II/III Framework implementation; and (iii) supervisory guidelines on governance, risk management and disclosure of climate-related financial risk. The 3Rs plan focuses on changing the governance and operating model of CBE, shifting its lending/exposure from SOEs to the private sector. This shift is reinforced in the 5 directives that place limits on CBE's lending to SOEs on a go forward basis, a new ownership policy, a revised mandate and an updated strategic and business plan; and compliance of the CBE Board in compliance with fit and proper and corporate governance directives issued by NBE (including one-third independent directors). Three additional directives will be supported under FSSP: (i) internal controls and risk management; (ii) prompt corrective action; and (iii) licensing. The implementation of the 3Rs plan is supported through the recognition and write-down of non-performing SOE debts and replacement with a government bond and reduction in the on-balance negative FX NOP. Additional major areas of support by the World Bank in the financial sector include: • Provision of TA and capacity building on capital goods leasing, deposit insurance, digital financial services, SME finance, and Insurance Market Development. • Supporting the reform of the Credit Information System which includes purchase of an upgraded system which is at an advanced stage of procurement; and the World Bank is providing TA to expand the reach and effectiveness of the existing credit bureau. • Supporting the development of the Capital Markets in Ethiopia to support access to long-term financing. This project includes inter alia support to SME financing (crowd funding and invoice financing platforms) and the purchase of the capital market trading platform which is in an advance stage of procurement. • Credit market infrastructure – the moveable collateral registry is now operational, and there has been significant progress in the diversity of collateral being accepted against loans including camels, cows, and *teff* grains.
2. Energy sector	The World Bank's energy access strategy encompasses all technologies, grid, off-grid and mini-grid, based on least-cost principles and aligns with Ethiopia's national electrification program 2.0 (NEP2.0). The extensive World Bank engagement in the energy sector of Ethiopia with a portfolio of more than US$3 billion covers grid, mini-grid and off-grid electrification, network strengthening, regional integration, and sector reforms. The US$1.42 billion Power Sector Reform, Investment and Modernization in Ethiopia (PRIME) Program under the Multiphase Programmatic Approach (MPA) and financing for its first phase (PRIME-1, US$522 million) was approved by the World Bank's Board of Executive Directors on March 26, 2024. The Project Development Objective of PRIME-1 is to strengthen and expand the electricity network and enable renewable energy generation. The Financing Agreement (FA) was signed on April 7, 2024, and Parliament has ratified the project in May 2024. PRIME-1 consists of four components: 1) Distribution Network Refurbishment and Modernization (IDA US$184 million equivalent); 2) Transmission Network Strengthening and Modernization (IDA US$281 million equivalent), 3) Upstream Geothermal Site Preparation (IDA US$52.63 million equivalent), 4)

	Technical Assistance and Capacity Building at the Petroleum and Energy Authority (PEA) (IDA US$5 million equivalent). Component 1 is implemented by Ethiopian Electric Utility (EEU), components 3 and 4 are implemented by Ethiopian Electric Power. Preparation for the first batch of investment packages (e.g. technical design, Environmental and Social Impact Analysis, preparation of bidding documents etc.) is well advanced for both EEU and EEP, utilizing a project preparation advance and/or their own resources. Through the PRIME-1 project, the World Bank is supporting the energy sector's Financial Viability Plan (FVAP) which will be adopted this year, and identifies a roadmap to meet growing demand, reduce system losses, improve management efficiency, manage FX risks and deficits, improve service quality, and separate transmission and system operation functions/establish an independent system operator to enable private sector participation.
3. Revenue mobilization	The US$70 million Governance Modernization project is being prepared and complements the DPO; it has a domestic revenue mobilization reform component focused on improving tax administration through investments in digital systems, improved business processes and capacity building. The project will support improvements in excise collection, VAT collection and customs collections, and support more efficient taxpayer services. • Development of VAT regulations to operationalize implementation of the VAT law • Support major improvement of VAT e-platform for e-filing and e-payment • Implementation support for e-invoicing (B-to-B) and POS systems (B-to-C) rollout • Data analytics systems development and capacity building • Introduction of risk-based audit systems • IT systems to implement advance tax payment reform TA is also being provided to rationalize tax holidays and reform presumptive taxes in response to DPO-supported policy reforms. Separately, a Tax Administration Diagnostic Assessment Tool (TADAT) is planned by the IMF. UK FCDO is providing complementary support through building capabilities of a Tax Transformation Office which will also be supported by the World Bank-financed Governance Modernization project. This will enable sustainability of the reforms envisaged under the DPO.
4. Rural land reform	The development of the Rural Land Use and Administration Proclamation benefitted from close technical support from the World Bank, based on a platform of experience developed during project implementation support in many highland woredas (districts). Technical and methodological support was also provided through highly successful UK FCDO and Government of Finland-supported programs on the certification and registration aspects of the Proclamation, respectively. These central aspects are normalized in this reform through requirements for highly inclusive and participatory processes to be followed, the regulatory and guidance basis for which will be formalized through implementation directives and guidance documents included as an indicative trigger for the DPO-2. Pilots have demonstrated extremely strong household and local support for the policy reforms supported by the DPO series. Implementation of piloting has also been supported with robust Grievance Redress Mechanisms (GRM) at local level, which address local level complaints and grievances as land is certified and registered. The GRM mechanism is well-established and mainstreamed into the government structures and processes at all levels (national, regional, district/woreda and local/kebele). The GRM system is fully operational and tested. Furthermore, monitoring by World Bank-financed operations has reported on its effectiveness and functionality over the last 4 years of piloting and this has been reported over successive publicly disclosed Implementation and Status Results Reports over the last few years of piloting.
5. Safety nets reforms	The World Bank, along with several other development partners, supports the government's two big safety net programs. The Rural Productive Safety Net Program (PSNP) is the government's flagship rural social protection program, launched in 2005, which provides social assistance to poor and vulnerable households in targeted rural woredas through public works linked cash and food

	transfers, direct cash and food transfers, shock-responsive cash and food transfer support, tailored livelihood enhancement interventions and linkages to available social services. The Urban Productive Safety Nets and Jobs Program (UPSNJP) is the flagship urban social protection program, launched in 2016, which provides social assistance to poor and vulnerable households in targeted urban areas through public works linked cash transfers, direct cash transfers, shock-responsive cash transfers and recovery support including for Internally Displaced Persons (IDPs), re-integration of urban destitute, tailored livelihoods enhancement interventions, integration of refugees and hosts, youth apprenticeships and development of job search ecosystem. Existing safety net programs operate in 485 rural woredas and 88 cities and towns supporting nine million people with regular transfers, with an ability to efficiently expand horizontally to support more people in these locations. Safety nets have been at the forefront of responding to the various crises, such as droughts, COVID-19, and conflict-driven displacements. In 2022 and 2023, the rural PSNP supported more than four million people to cope with drought-related shocks and the UPSNJP supported 700,000 IDPs. There is a possibility to scale up the basic safety net structures to other non-PSNP woredas and non-UPSNJP cities by potentially leveraging woreda/city specific purpose grants and complementing with basic safety net systems. While conflict is extremely widespread, the presence of safety nets in post conflict regions is significant. • In Tigray, the two safety nets cover 56 rural woredas and 6 urban towns and collectively support 1.31 million people. • In Amhara region, which is currently in the grip of serious conflict, the safety net operates in 87 rural woredas and 18 urban towns, collectively supporting 2.1 million beneficiaries. • In Afar region, which was also significantly impacted by the Northern Ethiopian conflict, the safety nets operate in 35 rural woredas and 3 urban towns supporting 609,000 beneficiaries. • The urban safety net program has experience supporting conflict-induced displacement having supported IDPs in six regions (Oromia, Amhara, Afar, Benishangul-Gumuz, SNNP and Harari) with shock-responsive cash transfers and recovery grants. This is now being expanded to Tigray and Somali regions.
6. Monitoring of the social impact of reforms	The World Bank has an ongoing program of TA and capacity building to the Ethiopian Statistical Service (ESS) and the Ministry of Planning and Development that provides a foundation for the monitoring of the social impacts of reforms. The TA to the ESS is focused on supporting the design, implementation and processing of a multi-topic consumption and labor force survey, expected to be rolled out for 12 months between July 2024 and June 2025. This survey can enable the GoE to monitor consumption and employment across rural and urban areas. Ongoing conflict could affect the implementation of this survey. The TA and capacity building activities with the MoPD are focused on welfare and poverty analysis, and on conducting distributional impact analysis of reforms, including subsidy reforms. Additionally, the World Bank will explore the potential to conduct phone surveys with urban households and informal enterprises, and to monitor retail prices leveraging the information collected by the ESS.