AFRICAN DEVELOPMENT BANK GROUP

Ethiopia: Accelerating Reforms for Inclusive Growth and Structural Transformation

Country Diagnostic Note

December 2021

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ACKNOWLEDGMENTS

This report is part of the African Development Bank's analytical work focused on informing its dialogue with the government of Ethiopia and providing a factual, analytical basis for the next Country Strategy Paper. It was prepared in the Vice Presidency for Economic Governance and Knowledge Management under the general direction of Kevin Chika Urama, Acting Chief Economist and Vice President, with overall guidance from Emmanuel Pinto Moreira, Director, Country Economics Department; Nnenna Nwabufo, Director General; and Abdul Kamara, Deputy Director General, East Africa Regional Hub. Edward Sennoga, Lead Economist, East Africa Regional Office provided technical guidance and leadership during the note's preparation.

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CURRENCY EQUIVALENTS

Currency		=	Ethiopian birr (ETB)
UA	1.00	=	1.417 USD
UA	1.00	=	1.215 EUR
USD	1.00	=	47.15 birr

As of 31 October 2021

WEIGHTS AND MEASURES

Metric system

GOVERNMENT FISCAL YEAR

July 7- July 6

EXECUTIVE SUMMARY

1. **After several decades of low and erratic growth, in 2005 Ethiopia entered an era of rapid economic expansion.** Led by public investments in transport, energy, and social infrastructure, annual GDP growth averaged 10.3 percent during 2005-19. Despite COVID-19 and associated trade and travel disruptions, GDP grew 6.1 percent in 2020. Per capita income jumped from $120 in 2003 to $920 in 2020, and poverty fell from 44 percent in 2000 to 23.5 percent in 2016. If such trends continue, Ethiopia's GDP per capita will double by 2034.

2. **But there are signs that Ethiopia's economic growth model might be running out of steam.** GDP growth slowed to 7.6 percent in 2018-19 and is projected to be just 4.0 percent in 2021, largely due to COVID-19 and the ongoing conflict in Tigray and its spillovers to other parts of the country. Growth is projected to recover to about 4.6 percent in 2022 and 5.8 percent in 2023. For that to happen, the government must provide the right enabling environment, sustain inclusive reforms, ensure political stability, and foster social cohesion.

3. **In 2020 industry accounted for 29 percent of GDP and services for 39 percent—reflecting the sectors' growing prominence over agriculture, which accounted for 33 percent.** The bulk of the growth in industry came from construction and in services from hospitality (hotels and restaurants). The contribution of manufacturing increased modestly, from 4 percent of GDP in 2000 to 7 percent in 2020. Manufacturing is affected by the global trend toward capital-intensive production with few employment opportunities for unskilled workers. Since 2004, three-quarters of manufacturing growth has come from large, capital-intensive firms with limited ability to rapidly expand employment opportunities.

4. **Labor productivity has risen since 2004, averaging 5.8 percent a year.** But while total factor productivity grew 5 percent a year during 2004-11, it has been falling since. Productivity growth since 2012 (4.4 percent a year) has largely been due to capital accumulation—mostly physical capital—in response to public infrastructure investments. The drop in total factor productivity could have been triggered by disruptions to economic activity due to protests demanding increased economic and political participation since 2015, conflicts, and shocks such as COVID-19, climate change, and desert locust invasion. The drop shows that Ethiopia's recent growth was mostly extensive rather than intensive, relying more on increases in labor and capital use rather than greater production efficiency.

5. **Several macroeconomic imbalances have accrued.** Rising public debt—from 35 percent of GDP in 2009 to 50 percent in 2021, with external debt accounting for 27 percent and domestic debt 23 percent—has increased debt distress. Export performance weakened from 16.6 percent of GDP in 2004 to 8.0 percent in 2020. The declining export performance, coupled with high and volatile double-digit inflation, risks derailing Ethiopia's growth trajectory and has hit poor people and vulnerable groups (such as women, youth, and the elderly) especially hard. Ethiopia benefited from the G20 Debt Service Suspension Initiative (DSSI), and the government is taking steps to contain the debt burden including by pursuing fiscal consolidation, expanding public financing sources, putting a moratorium on nonconcessional borrowing, harnessing grants and soft concessional loans, and restructuring debt.

6. **The high economic growth of recent years has not translated into rapid structural transformation or increased job opportunities.** Though poverty fell between 2000 and 2016, inequality—as measured by the Gini coefficient—rose from 0.28 to 0.33 over the same period. Income inequality increased because of disparities between urban and rural

households, with urban households experiencing strong growth in consumption and rural ones seeing a decline. In 2020 urban unemployment was high, at 18.7 percent (compared with 2.0 percent in rural areas), and especially pronounced among young people, at 25.0 percent. Reforms should continue to increase private sector participation in the economy and promote pro-poor growth, social cohesion, and political stability.

7. **Ethiopia urgently needs to address several hurdles holding back inclusive growth and structural transformation.** First, the government must accelerate macroeconomic reforms to mitigate market distortions. Implementation of prudent, well-coordinated fiscal and monetary policies would reduce macroeconomic uncertainty. Ending capital and financial repression would increase real annual GDP growth by 2 percentage points a year, and a gradual transition to a market-determined exchange rate would improve foreign currency management. Fiscal consolidation and improved capacity for debt management would help ensure that Ethiopia's debt-carrying capacity is sustainable.

8. **The weak enabling framework is another major hurdle for inclusive growth and structural transformation.** Investments in enablers of structural transformation—such as human capital development, high-quality and sustainable infrastructure, increased agricultural productivity, and efficient institutions—would increase private sector participation and economic transformation. Reforms that promote private sector participation in all stages of the value chain would accelerate investment and economic growth. Improving logistics management and trade facilitation, overcoming foreign exchange shortages, and ensuring an adequate, reliable energy supply would enable scaling up industrialization and manufacturing. An innovative services sector is crucial to increasing financial access for micro, small, and medium-size enterprises, which would accelerate industrialization.

9. **Limited regional integration constrains trade as well as inclusive growth and structural transformation.** Reforms are needed to deepen and diversify trade, export products, and markets for Ethiopian exports. The government could consider targeting increased processing for the domestic market in agriculture and light manufacturing (such as pharmaceuticals) given the country's population of 115 million people. Doing so would cushion Ethiopia from external shocks that limit export revenue and thus enhance job opportunities in agriculture, industry, and services. Ethiopia also needs to take advantage of the African Continental Free Trade Area (AfCFTA) agreement, which will help boost exports across Africa by lifting trade barriers. And harnessing the country's tourism potential through increased investments in air, road, and communications networks—as well as stronger institutions and better services—will contribute to higher foreign exchange earnings.

10. **Despite progress over the past 15 years, infrastructure coverage and quality gaps remain.** Less than half of Ethiopians live within 2 kilometers of an all-weather road, and the country is ranked second highest on energy access deficit in Sub-Saharan Africa and third highest globally. The government needs to balance investments in high-cost public infrastructure and state-owned enterprises with efforts to create an enabling environment for private sector participation, to bolster private investment and expand growth opportunities. Moreover, infrastructure spending relies on imported capital, exacerbating foreign exchange scarcity and crowding out small and medium-size private exporters. Developing optimal-grade infrastructure with extensive networks would have an enormous impact on reducing regional inequality. Domestic companies face weak logistics and low contracting capacity, limiting their ability to participate in infrastructure projects and thereby constraining the buildup of local wealth.

11. **Extensive and costly regulations should be simplified to promote participation and transparency and to expand the formal sector.** Nearly one-sixth of urban jobs are in the informal sector, which accounts for nearly two-fifths of GDP. The Home-Grown Economic Reform (2019-21) and Ten-Year Development Plan (2021-30) have proposed reforms to promote the role of the private sector and strengthen public services and state-owned enterprises. Yet the costs of

doing business remain high, exacerbated by Ethiopia's weak regulatory framework, limited access to finance and electricity, high trade logistics costs, small domestic market, and landlocked location and distance from the sea. Lack of firm-level growth and innovation—due to structural barriers and weak entrepreneurial skills—limit firms' ability to achieve economies of scale.

12. **Gender imbalances remain in access to resources.** Ethiopian women face significant barriers to economic participation and realization of their full potential. Women are underrepresented and undervalued in labor markets and are affected by prejudices and harmful traditional practices.

13. **This report identifies seven priority areas to support inclusive growth and lay the groundwork for sustainable development and resilience:**

- ***Accelerate economic reforms***—prudent fiscal and monetary policy management, financial inclusion—to eliminate market distortions and lay the foundation for structural transformation.
- ***Invest more in growth enablers***—human capital and skills development, quality infrastructure, strong institutions—to support poverty reduction, youth employment, and gender equality.
- ***Enhance agricultural production and productivity t***hrough increased commercialization, taking advantage of integrated agro-industrial parks and new technology.
- ***Expand the private sector's role in the economy*** by sustaining reforms, liberalizing key sectors, and improving regulation to increase competitiveness and innovation while protecting the poorest and most vulnerable—for example, through social protection and active labor market programs.
- ***Foster industrialization and manufacturing*** by addressing foreign exchange constraints, facilitating trade, filling infrastructure gaps, and expanding access to energy.
- ***Scale up trade diversification and regional integration efforts*** to increase exports by addressing nontariff barriers and border clearance procedures to benefit from the AfCFTA agreement.
- ***Harness the potential of tourism and urbanization*** by improving services and urban planning.

14. **Efforts are also needed to strengthen the social contract between the government and the people and to reinforce social cohesion to ensure shared prosperity and enhance peace and stability.** Such efforts can be supported by the principles of do no harm and leaving no one behind. Steps should also be taken to expand economic and political participation and ensure equal opportunities for all citizens, given Ethiopia's diverse population. Finally, the Ministry of Peace should ensure continuous engagement at all levels to establish and address the root causes of conflict.

15. **The African Development Bank has established itself as a trusted development partner in Ethiopia.** National development aspirations are well-aligned with the Bank's High 5 priorities and several Bank strategies and policies. Going forward, the Bank will provide sustained support for Ethiopia's development priorities. This support will focus on inclusive, sustainable infrastructure development and economic and governance reforms to achieve national development goals through increased private sector engagement in the economy, improved institutional efficiency, and transformative growth that fosters resilience.

CHAPTER:

1

A RISING STAR IN AFRICA SADDLED BY CONSTRAINTS

This report assesses Ethiopia's efforts to achieve inclusive growth and structural transformation under its current industrialization policy agenda. Several constraints have kept the country from realizing its goals of industrialization and middle-income status. Located in East Africa, Ethiopia is the continent's second most populous country, with a population of 115 million people (2021) growing by 2.7 percent a year.[1] With nominal GDP per capita of $920 in 2020, Ethiopia is a low-income country and among the poorest countries globally. About 80 percent of the population lives in rural areas, but urbanization is growing by 4.6 percent a year (AfDB data; FDRE 2021).

With a landmass of 1.1 million square kilometers, Ethiopia is landlocked—its only access to the sea is through the Port of Djibouti. Though 95 percent of Ethiopian cargo passes through Djibouti, competition is expected from alternative ports such as Berbera, Lamu, Mombasa, and Port Sudan (ITA 2021). Following the landmark peace and trade agreements of 2018, relations with Eritrea have improved and the sea route through Assab is being considered. In 2018 Ethiopia and Somalia announced plans to jointly invest in four ports to attract foreign investment. Ethiopia is a key player in regional integration as it hosts the African Union and is a member of the Inter-Governmental Authority on Development (IGAD), Horn of Africa Initiative, Common Market for Eastern and Southern Africa (COMESA), and African Continental Free Trade Area (AfCFTA).

Ethiopia is a multiparty federal parliamentary republic, with a titular president as head of state and an executive prime minister. Prime Minister Dr. Abiy Ahmed was reelected by the House of Peoples' Representatives in October 2021 after a general election in June 2021. Ahmed was first elected prime minister in April 2018 following months of political protests and the resignation of Prime Minister Hailemariam Desalegn, who had held the position since 2015. Several reforms have been undertaken to expand economic and political participation. In 2018 Dr. Sahle-Work Zewde was appointed Ethiopia's first female president and the Cabinet was restructured, making it gender balanced. Ethiopia comprises 11 regional states and two city administrations. Except for military, financial, and foreign policy matters, each region has its own independent institutional arrangements.

Between 2004 and 2019 Ethiopia recorded one of the world's highest economic growth rates, averaging 10.5 percent. But that growth—which was propelled by large

[1] Ethiopia's fiscal year runs from 7 July to 6 July. This report uses calendar years throughout so, for example, 2020 refers to the 2019/2020 fiscal year. Unless otherwise indicated, all data in the report are from the African Development Bank's Statistical Department.

public investments in physical and social infrastructure—has since decelerated due to macroeconomic imbalances, structural constraints, and economic shocks. In 2020 GDP growth slowed to 6.1 percent, largely because of COVID-induced lockdowns and a desert locust invasion. That year, agriculture accounted for 32.7 percent of GDP, industry for 29.0 percent, and services for 39.3 percent. Growth in services has mainly been driven by the hospitality subsector (hotels and restaurants), while industry is driven by construction with many activities led by micro, small, and medium-size enterprises. Progress on human development, skills, and health care services has been slow. In 2019 Ethiopia scored 0.470 and ranked 173rd of 189 countries on the United Nations Development Programme's Human Development Index (UNDP 2020). But life expectancy increased from 62 years in 2016 to 66 years in 2020, and child mortality fell from 123 deaths per 1,000 births in 2005 to 55 per 1,000 in 2019. Improvements in life expectancy and child mortality are attributed to increased healthcare services and investments in infrastructure and energy.

CHAPTER: 2

MACROECONOMIC PERFORMANCE AND PROSPECTS

This chapter discusses trends in Ethiopia's growth over the past four decades (through 2020) as well as its current development strategy and recent economic performance and prospects.

2.1 Growth Models and Outcomes

This section assesses Ethiopia's past economic models, identifying challenges and gaps to inform priority reforms for faster growth.

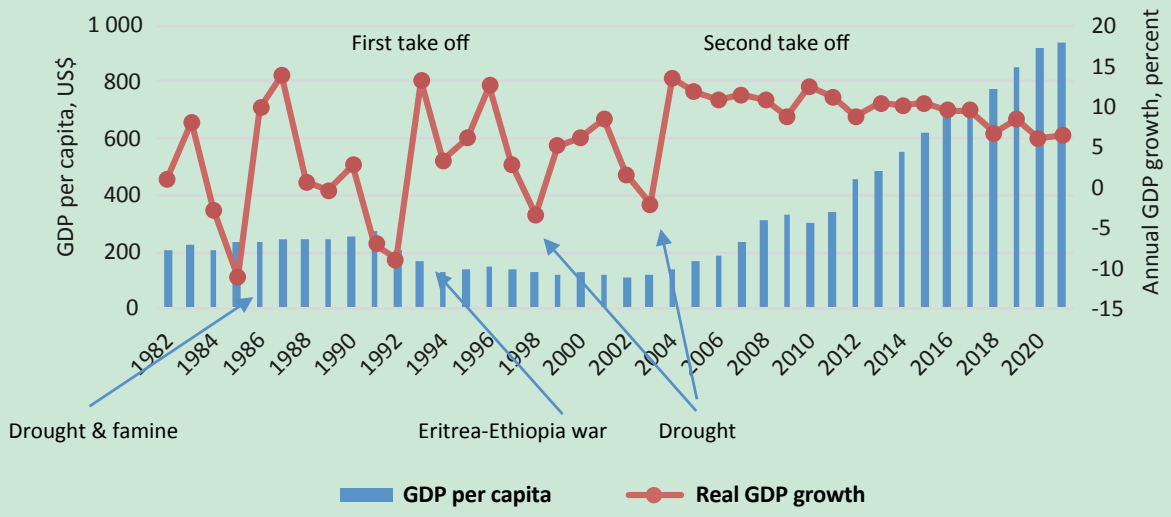
2.1.1 Economic History and Outlook

Over the past four decades, Ethiopia's economic growth has been erratic, reflecting differences in governance and historical events and shocks. GDP data start from 1981 and show a surge in growth, from 0.8 percent a year in 1981-93 to 8.3 percent a year in 1993-2019 following an industrialization drive and reform efforts (figure 2.1). During 2010-15 annual GDP growth averaged 10 percent, driven by strong performance in industry, agriculture, and services.

Ethiopia has experienced two periods of growth take-off. The first was during 1993-2001 and the second, during 2004-16. But these accelerations in growth were not supported by sufficient innovation and capital accumulation to maintain the momentum and transition Ethiopia into an industrial economy. GDP contracted n 1983-84, 1991-92, and 2003 as a result of extensive droughts and famine and in 1998 after the country's war with Eritrea. With nominal GDP per capita of about $920 in 2020, Ethiopia is a low-income country—among the poorest in the world. In purchasing power parity terms, GDP per capita was less than $1,000 until 2005, when it started rising rapidly to $2,500 by 2020. Ethiopia has maintained a relatively closed economy and been slow to integrate with the global economy.

Previous growth strategies did not pursue diversification to spread growth and nurture private sector participation in the economy. Unemployment was high and income inequality rose. In addition, exports remained weak due to falling commodity prices and delays in operationalizing export-oriented investments. In recent years, COVID-19 and desert locust shocks, macroeconomic imbalances, and structural rigidities have slowed growth. Economic and political reforms initiated in 2018 to expand the role of the private sector and improve governance have yet to generate benefits.

Figure 2.1: Real GDP growth and GDP per capita in Ethiopia, 1981-2020



Source: AfDB data; Conference Board 2021; World Bank 2021a.

Since 2004 Ethiopia has maintained robust GDP growth, underpinned by public investments in transport infrastructure, energy, industrial parks, and social services. During 2001-19 real GDP growth averaged 8.4 percent a year, nearly twice the Sub-Saharan average. Despite COVID-19, in 2020 growth was 6.1 percent—down from 8.4 percent in 2019 but more than eight times the East African average (table 2.1).

Growth has moderated in recent years, underscoring the limitations of the public sector-led growth model. Problems include mounting macroeconomic imbalances (rising public debt, inflation, foreign currency scarcity), structural bottlenecks, and capacity weaknesses. Ethiopia is vulnerable to shocks including conflicts, desert locusts, and most recently COVID-19 (box 2.1). Ongoing political, economic, and financial reforms—underpinned by the Home-Grown Economic Reform (2019-21) agenda and Ten-Year Development Plan (2021-30)—should help boost growth and domestic resource mobilization. COVID-19 and ongoing conflict in northern Ethiopia have undermined the macroeconomic outlook. GDP growth is estimated to have dropped to 4.0 percent in 2021 but is projected to rise to 4.6 percent in 2022 and 5.8 percent in 2023 (see table 2.1).

Table 2.1: Key macroeconomic indicators for Ethiopia, 2018-23

Indicator	2018	2019	2020	2021(e)	2022(e)	2023(p)
Real GDP growth (%)	6.8	8.4	6.1	4.0	4.6	5.8
Inflation (%)	13.8	15.7	20.3	21.2	18.3	14.8
Overall fiscal balance, incl. grants (% of GDP)	-3.0	-2.5	-4.7	-5.8	-5.6	-4.9
Current account balance, incl. grants (% of GDP)	-6.5	-5.3	-2.8	-6.5	-6.0	-5.0

Source: AfDB data; September 2021.

Box 2.1: How has COVID-19 affected Ethiopia, and how has the government responded?

Impact on the economy. COVID-19 has had significant negative impacts on the economy and livelihoods. Between 2019 and 2020 GDP growth fell from 8.4 to 6.1 percent and the fiscal deficit rose from 2.5 to 4.7 percent of GDP. Revenue targets were not met, and between 2020 and 2021 public debt increased from 51 to 56 percent—narrowing Ethiopia's fiscal space. On a positive note, the trade deficit improved by 12 percent in 2020 thanks to increased exports of goods such as gold, coffee, and flowers. Reduced imports, especially from China, played a role in narrowing the trade deficit. The Job Creation Commission reported that of the 3.4 million job opportunities created in 2020, nearly 10 percent were lost due to COVID- 19. Moreover, about 1.5 million jobs are at risk, which will likely exacerbate poverty.

Impact on women and girls. Women are more vulnerable to COVID-19 due to their roles as front-line health workers and primary household care providers. Increased demand for health services due to COVID-19 has reduced women's access to reproductive healthcare, especially prenatal services, and family planning. With the slowdown in economic activity, more women are vulnerable because many depend on subsistence employment and the informal sector. Increased household stress over economic shocks, prolonged coexistence in cramped living quarters, and reduced access to critical protection services and support networks during the pandemic could increase domestic violence. And in the absence of a vigorous back-to-school campaign, the primary school dropout rate for girls is expected to rise from the current 17.3 percent.

Policy responses. Ethiopia deployed monetary and fiscal stimulus packages to mitigate the effects of COVID-19, maintain economic functions, and build resilience by cushioning businesses—especially micro, small, and medium-size enterprises—against trade and travel disruptions and supporting vulnerable populations. In 2020 the government allocated about $154 million (0.15 percent of GDP) to strengthen the health sector's response to the pandemic and $430 million (0.4 percent of GDP) for health sector responses in a worst-case scenario of community spread (IMF 2021c). Tax reforms were delayed, and payment incentives were provided to ease the burden on taxpayers. The National Bank of Ethiopia provided $470 million in liquidity to private banks to facilitate debt restructuring and prevent bankruptcies. A state of emergency was imposed between March and August 2020 to help security agencies support implementation of containment measures.

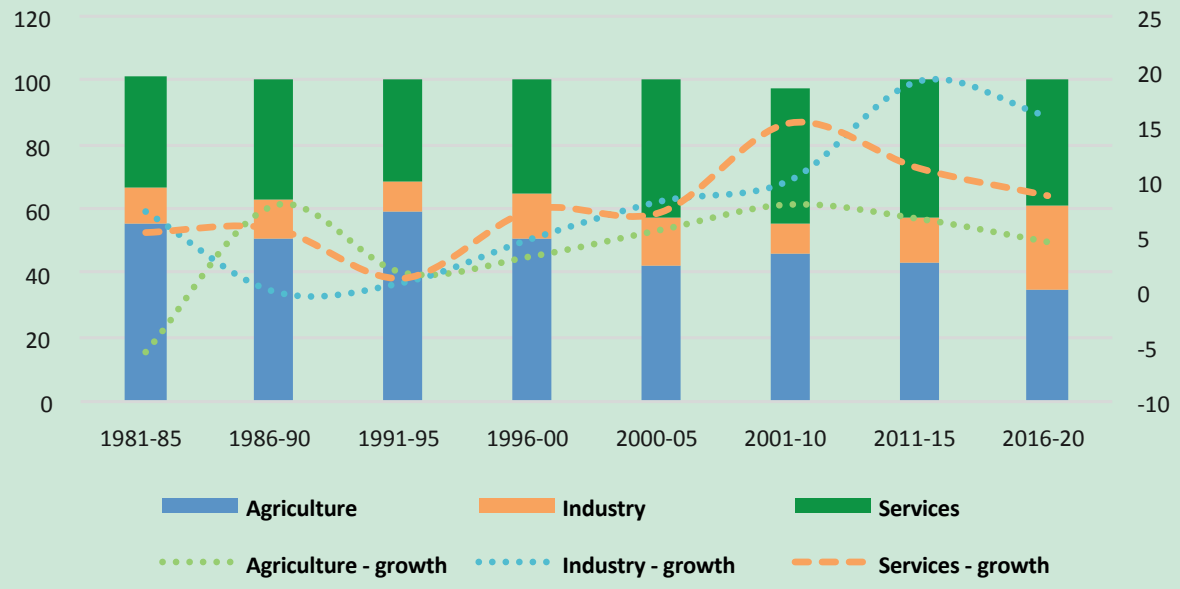
Recovery and sustainability. By August 2020 the government had eased most containment measures to ensure continuity of economic activities. The state of emergency ended in September 2020. But other health-related containment measures—such as requiring a negative COVID-19 test to enter the country, handwashing at all commercial buildings, mandatory wearing of masks in public, physical distancing, and awareness campaigns—remained in place. Full reopening will require stepping up vaccination rates, as only 3 million people (2.6 percent of the population) have been vaccinated (WHO 2021).

Bank support. The Bank supported the government's mitigation efforts through the $165 million Emergency COVID-19 Budget Response, approved in July 2020.The Bank could support additional interventions to safeguard the economy, including promoting public-private partnerships for energy, transport, and information and communications technology projects; designing strategies to cope with COVID-19's impacts on trade and investment including by strengthening trade regulations and streamlining customs processes and tax collection; and providing technical assistance to key industries and agriculture value chains to raise productivity, improve product quality, and expand access to new markets.

2.1.2 Composition of GDP

The composition of Ethiopia's GDP is changing, with services accounting for the biggest share. The contribution of agriculture value-added to GDP dropped from more than 50 percent before 2001 to about 34 percent in 2016-2020 (32 percent in 2020; figure 2.2). Meanwhile, the share of services in GDP rose from 35 percent before 2001 to 40 percent in 2020. Industry's contribution to GDP nearly tripled to about 29 percent over the same period, driven by construction (72.5 percent) and manufacturing (24.0 percent).

Figure 2.2: Sectoral composition of GDP in Ethiopia, 1981-2020



Source: National Bank of Ethiopia 2021.

2.1.3 Drivers of Ethiopia's GDP Growth

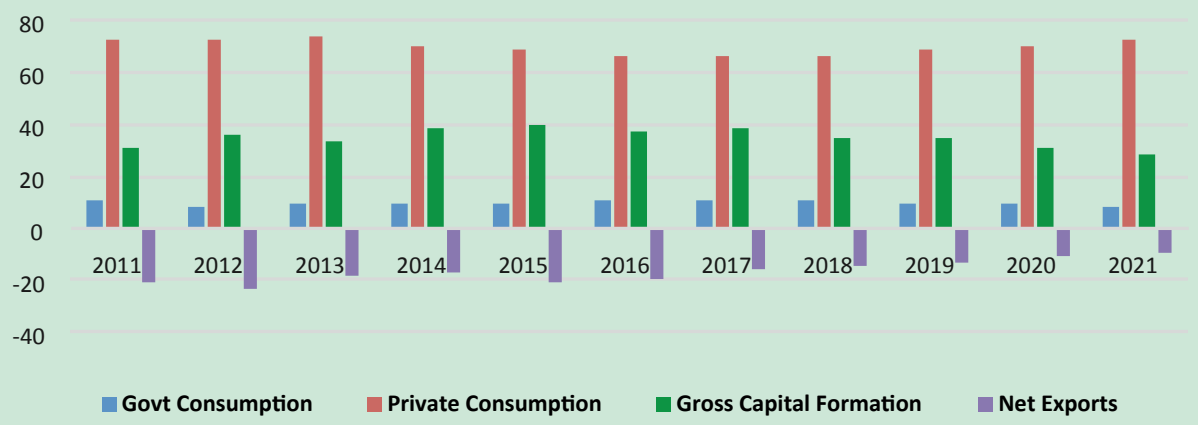
Ethiopia's GDP growth during 2011-20 was mainly driven by industry and services. But the contributions of the two sectors to GDP growth have slowed since 2012. During 2016-20 agricultural growth averaged 4.5 percent, services 8.7 percent, and industry 15.9 percent, compared with 6.6 percent, 11.2 percent, and 19.0 percent in 2011-15. In 2020 industrial growth was driven by construction (9.9 percent growth) and manufacturing (7.5 percent); services were driven by health and social services (12.9 percent) and financial intermediation (10.2 percent). In 2020 the hospitality subsector (hotels and restaurants) grew by just 2.0 percent while transport and communications grew by 1.1 percent due to COVID-19 and associated containment measures, compared with 9.0 percent and 21.0 percent in 2019.

On the demand side the economy is dominated by household consumption, which during 2011-20 averaged 67 percent of GDP compared with investment at 37 percent (figure 2.3). Net exports averaged -15 percent during that period, though began improving in 2015. Strong household consumption reflects government investments in services and infrastructure that have scaled up economic activities and raised household incomes.

2.1.4 Structural Transformation

Structural transformation is occurring, albeit slowly. Even though the contribution of agriculture to GDP has declined since 2000 while that of services has increased (see figure 2.2), agriculture still accounts for about 70 percent of jobs in Ethiopia. Within agriculture, crop production contributes the largest share (63 percent), followed by animal husbandry (26 percent) and forestry (11 percent). Employment in services accounts for only 22 percent of the total, implying that activities in the sector are not labor-intensive—which, along with unfavorable private sector policies and conflicts, limit structural transformation of the sector. In 2019 industrial employment was 9.3 percent of the total.

Figure 2.3: Demand-side composition of GDP in Ethiopia, 2011-20



Source: AfDB data.

Structural transformation picked up slightly around 2010-12, when industry's contributions to GDP began a period of uninterrupted growth, driven by construction. This has been associated with the movement of labor from agriculture to construction. Although manufacturing remains small, there are early signs that it is beginning to accelerate, most likely due to the improved state of infrastructure and public services arising from the many years of public investments.

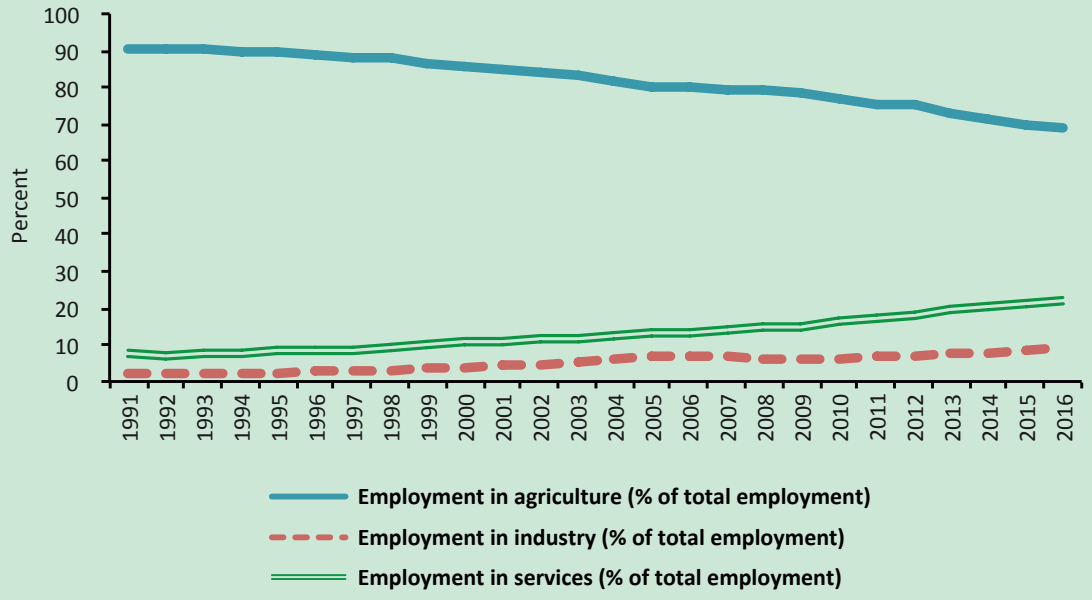
The rise in industry's contribution to GDP seems premature—especially in the absence of a healthy expansion in manufacturing—and has not generated as many wage-paying jobs as would have been expected from growth in manufacturing. This pattern reflects the rapid growth of transport, propelled by Ethiopian Airlines, and construction industries, which grew quickly thanks to the same development strategy fueled by public investments. If the economy's competitiveness improves, Ethiopia could increase both manufacturing and services in terms of absolute values and as shares of GDP. Growth in services could expand employment opportunities with links to industry and agriculture.

Ethiopia's growth model aims to encourage investments in infrastructure and production activities. The focus is on expanding light manufacturing activities that link agriculture, labor, and exports, as well as investment in strategic support industries (such as renewable energy). Ethiopia has identified seven strategic investment areas: pharmaceuticals, agroprocessing, textiles, leather, horticulture, tourism, and energy. Robust growth over the past 15 years points to the success of the "targeted and focused state intervention and industrial policy as the vehicle for Ethiopia to catch-up" (Haile

2019). The Ten-Year Development Plan for 2021-30 sets targets for contributions to GDP for agriculture at 22 percent by 2030, for industry at 36 percent, and for services at 42 percent, respectively. The target for manufacturing is 17 percent of GDP.

The movement of labor from the less productive agricultural sector to the more productive services and industrial sectors has been slow (figure 2.4). The share of agricultural employment in total employment fell from 90.2 percent in 1990 to 69.0 percent in 2016 (World Bank 2021e). Employment in services increased from 7.7 to 22.0 percent of the total over the same period. This shift reflects growing urbanization, estimated at about 4.6 percent a year. Drivers of growth in services include wholesale and retail trade, financial intermediation, hospitality, and tourism. Employment in industry as a share of the total increased from 2.2 percent to 9.0 percent. Despite these changes, the pace of employment reallocation from agriculture to services and industry remains low.

Figure 2.4: Sectoral distribution of employment in Ethiopia, 1990-2016



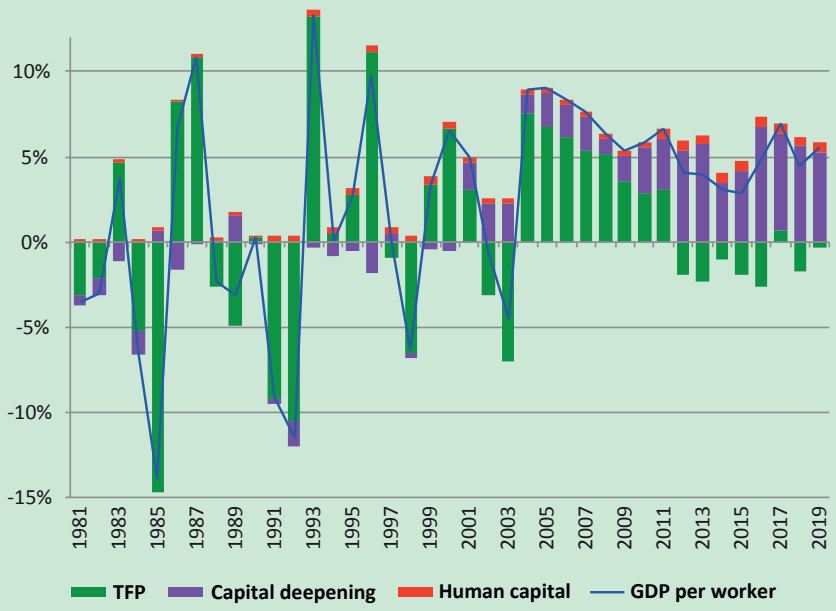
Source: World Bank 2021e.

Services and industry mainly offer low-skill, often temporary jobs. In addition, much of the labor transition is from low-productivity informal agriculture to low-productivity processing and urban-based retail services, rather than to the manufacturing and productive services crucial for rapid transformation. The modest expansion of manufacturing is one reason for the slow pace of structural transformation, reflecting limited wage-paying jobs to pull workers out of agriculture (World Bank 2019b). This pattern is somewhat common in Africa, where transition from agriculture is generally toward services without much change in manufacturing (AfDB 2016), which would be promising if services growth were driven by high-productivity subsectors that raise overall economic efficiency. Increased competition, innovation, skills development, and use of appropriate technology are needed to expand manufacturing's contribution to GDP growth, propel job creation, and advance structural transformation.

Since 1981 Ethiopia's total factor productivity (TFP) growth has fallen into roughly two periods. The first, from

1981 to 2003, saw erratic growth and swings in TFP from strongly negative (1985) to strongly positive (1993; figure 2.5). The negligible positive contribution from human capital (0.29 percent) during this period did not offset the negative contributions from physical capital (-0.15 percent) and TFP (-0.23 percent). The second period, from 2004 to 2019, was characterized by strong gains in labor productivity averaging 5.8 percent a year. TFP grew strongly at 5.0 percent until 2011 but declined by an average of 1.4 percent a year until 2017 (see also Degu and Bekele 2019 and Diao and others 2021). The drop in TFP was partly compensated by capital deepening, which contributed 5.3 percentage points to GDP per capita growth during 2012-19 compared with 1.9 percentage points during 2004-11. The 4.4 percent annual growth in TFP after 2012 was driven by physical capital accumulation due to infrastructure investments and to a lesser extent human capital. The fall in TFP could have been triggered by disruptions to economic activity from protests, conflicts, and shocks.

Figure 2.5: Sources of total factor productivity growth in Ethiopia, 1981-2019



Source: Conference Board 2021; Feenstra, Inklaar, and Timmer 2015; World Bank 2021a.

Ethiopia's labor productivity is well below the Sub-Saharan average for 2013-19—by 25 percent in agriculture, 21 percent in industry, and 33 percent in services. This underscores the slow pace of structural transformation since labor productivity is relatively low across all sectors. During 2004-19 only 1.0 percentage point of the 6.9 percent annual productivity growth was attributable to labor moving to higher-productivity sectors. The remaining 5.9 percentage points came from intra-industry productivity growth. **Growth in manufacturing—on which Ethiopia has set high hopes of fostering structural transformation and absorbing it growing labor force—has been slow.** The contribution of manufacturing to GDP has remained flat, partly due to the lowproductivity of workers in the sector, dampening additional investment projects. The average Ethiopian manufacturing firm sells $14,180 worth of output per worker each year, less than one-third the average for firms in Kenya ($46,420) and Vietnam ($48,755; Caria 2019). This implies that Ethiopia's low labor cost advantage is wiped out by low productivity, jeopardizing its vision of becoming East Africa's manufacturing hub. This is partly explained by low skills and scores in labor management, especially in terms of worker selection and retention. In addition, manufacturing has become increasingly capital-intensive in Ethiopia (Diao and

others 2021). While the average Ethiopian firm works with less than 10 percent of the capital-labor ratio of similar firms in developed countries, the ratio is much higher in manufacturing.

Ethiopia seems to be missing the high-employment advantage in manufacturing by failing to start from low-level processing and jumping to capital-intensive investments, especially in garments. Since 2004 about three-quarters of Ethiopia's manufacturing output has come from large, capital-intensive firms that offer few opportunities for unskilled labor. And because nearly as much of industrial growth comes from construction, little room is left for organic industrialization through manufacturing growth. Large Ethiopian firms have much lower net employment growth than do small ones (Söderbom, Shiferaw, and Alemu 2021). Once firms adopt capital-intensive technology, their ability to increase manufacturing output and generate employment in response to new opportunities is reduced because capital is not as e asily scalable as labor (Diao and others 2021). This problem is exacerbated by constraints—such as limited access to credit and foreign currency scarcity—faced by firms importing intermediate inputs (see section 2.5).

2.1.5 Poverty, Inequality and the Spatial Distribution of Growth

Ethiopia's growth has been relatively inclusive, with poverty declining from 44.0 percent in 2000 to 23.5 percent in 2016. This improvement is attributable to highly pro-poor spending and infrastructure spending, estimated at almost 60 percent of the 2020 budget. But inequality, as measured by the Gini coefficient, rose from 0.28 in 2000 to 0.33 in 2016 (see section 4.5). The wealthiest 10 percent of the population holds 31.4 percent of national income, while the poorest 40 percent accounts for only 17.6 percent (UNDP 2018). There are large differences across regions: Gambella and Dire Dawa are the best-performing regions and Somali the poorest. Women have lower educational attainment and face more barriers to entering and staying in the formal labor force, with up to a 30 percent wage gap for similar work. The government is committed to advancing women's rights and economic empowerment through increased access to education and leadership opportunities.

Economic activities are concentrated in urban areas, and growth varies by region. Urban, densely populated areas attract a disproportionate share of public and private investments because they have larger markets for goods and services. For example, more than two-thirds of medium-size and large firms are in Addis Ababa, Oromia, and the Southern Nations, Nationalities, and Peoples' Region (SNNPR). These three regions account for 66 percent of the population and more than 90 percent of investment in manufacturing. Regional disparities are also prevalent in the number of domestic and foreign investment projects, amount of capital invested, and number of jobs created (Seid and Lamesegen 2019). Manufacturing investment is largest in Addis Ababa (30 percent), followed by SNNPR (27 percent), Oromia (18 percent), and Tigray (15 percent). Addis Ababa accounts for 61 of investments in construction and Tigray, 14 percent.

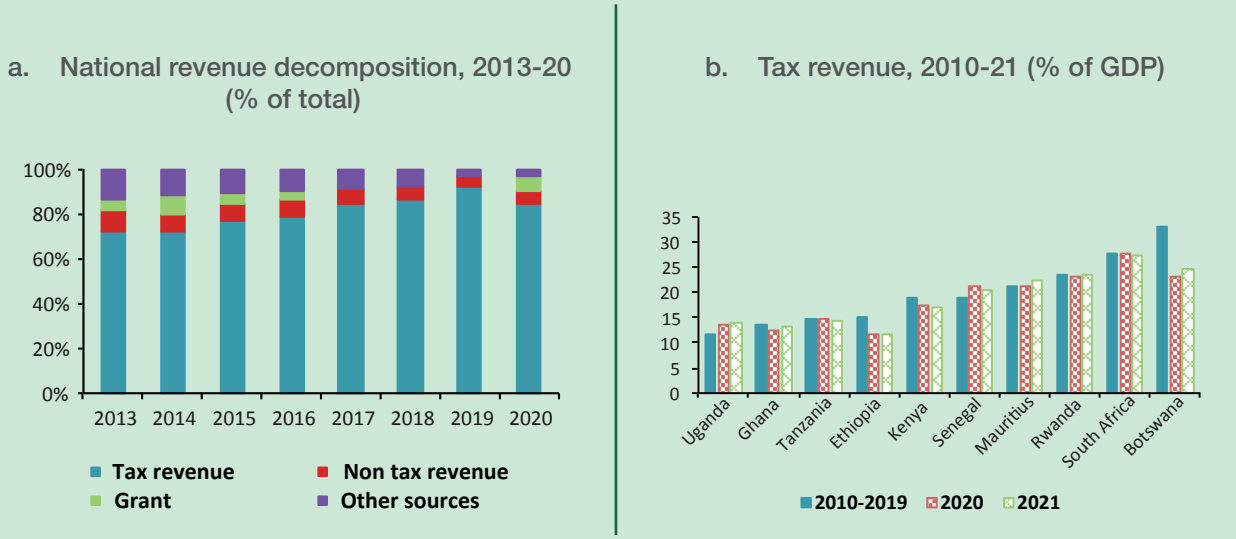
Three predominantly urban regions—Addis Ababa, Dire Dawa, and Harari—have benefited more from recent growth. These regions have far lower poverty rates (ranging from 7.0 percent in Harari to 16.8 percent in Addis Ababa) than predominantly rural regions (ranging from 20.7 percent in SNNPR to 27.0 percent in Tigray; World Bank 2020b). Disparities also exist in investments in agriculture and construction. Weather-related shocks disproportionately affect pastoralist areas in the dry lowlands of Afar, parts of SNNPR, Oromia, and Gambella. These shocks are exacerbated by inadequate access to basic infrastructure such as roads, electricity, markets, warehousing, water, healthcare, education, and farm inputs. Expanding infrastructure development and relaxing energy constraints could address the regional disparities in growth, particularly between urban and rural areas. The Home-Grown Economic Reform (2019-21) plan aims to tackle regional disparities through the development of industrial parks in each region. Industrial parks created 64,000 jobs in 2019 and 71,000 in 2020 (FDRE 2021). The federal government controls most public resources for these parks, and there are large capacity gaps at the subnational level. This calls for stronger coordination between the federal and regional investment promotion offices and increased capacity at the regional level to expand opportunities for economic growth.

2.2 Fiscal Developments

Ethiopia's fiscal policy is oriented toward expanding growth and enhancing pro-poor social spending programs and safety nets. But limited fiscal space is a major constraint to the national development goals. Although Ethiopia has tried to increase tax revenue to finance a larger share of public expenditures from domestic resources, collections remain below expectations. Tax revenue averaged 78 percent of government revenue during 2013-20 (figure 2.6a). Tax revenue averaged 15 percent of GDP during 2010-19 but was only 12 percent in 2020-21, which is below regional peers such as Kenya, Rwanda, and South Africa (figure 2.6b). Low revenue generation is partly due to weak tax administration, a narrow tax base, and the susceptibility of tax revenue to shocks such as COVID-19.

The overall fiscal deficit, excluding grants, increased from 3.8 percent of GDP in 2018 to an estimated 4.7 percent in 2020. The fiscal deficit for 2021 is projected at 4.5 percent due to fiscal consolidation and gradual improvement in public revenue collection. Since 2005 the government has prioritized infrastructure and pro-poor social spending, which accounted for an estimated 60 percent of the budget in 2020 and was funded largely by external borrowing because of low tax revenue mobilization. During 2015-20 total savings as a share of GDP averaged 22.7 percent a year, of which public savings was only 2.0 percent. On the other hand, total investment averaged 37 percent of GDP, implying an average resource gap of about 14 percent a year during 2015-20.

Figure 2.6: Ethiopia's revenue sources and tax revenue relative to peer countries



Source: AfDB data. *Source: AfDB data; IMF 2021b.*

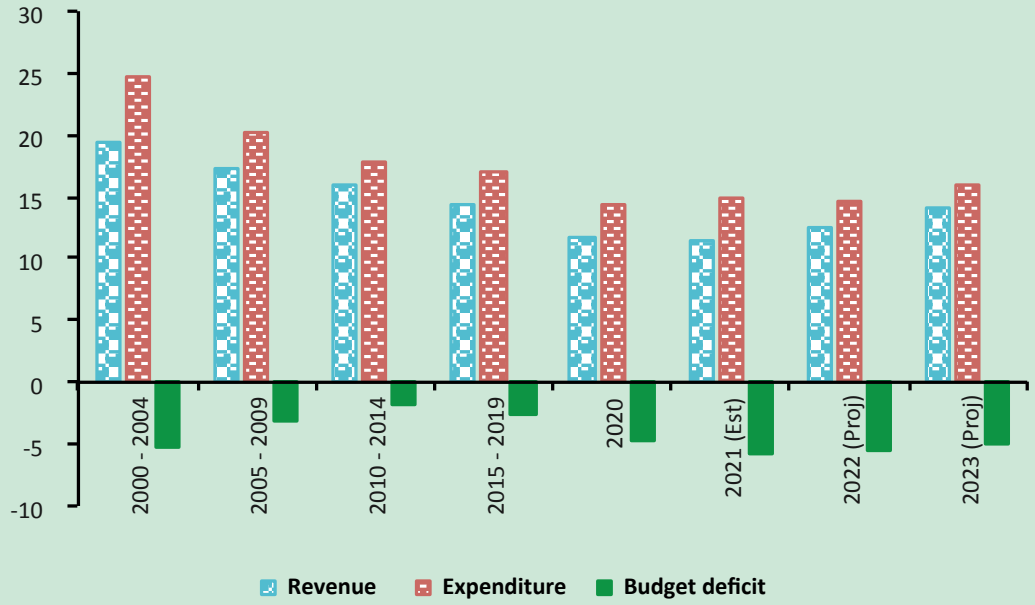
2.2.1 Budget Deficit

Ethiopia has maintained fiscal policy discipline since 2005. Because of enhanced fiscal discipline, the country earned A ratings on most categories of the 2019 Public Expenditure and Financial Accountability Assessment. Notably, the A ratings were reported in aggregate expenditure outturn and debt management (World Bank 2020c). The budget deficit more than halved between 2000-04 and 2015-19, from an average of 5.3 percent of GDP to 2.6 percent (figure 2.7;). The budget deficit is estimated to increase to 5.8 percent in 2021 from 4.7 percent in 2020 and projected to

remain elevated at 5.6 percent in 2022 and 4.9 percent in 2023. The higher deficits in 2020-21 reflect spending related to COVID-19. Some budget reallocations were made during 2017-20 following shocks such as droughts, floods, political instability, and COVID-19.

Ethiopia's ratio of tax revenue to GDP is low and has not matched the pace of economic growth due to weak tax administration—underscoring the potential to scale up tax collection through reforms. During 2018-20 tax revenue averaged 11 percent a year, below the Sub-Saharan average of 17 percent. Tax revenue could increase through improvements in tax administration and revisions to excise and value-added taxes. Total public spending fell from 18.2 percent of GDP in 2018 to 14.5 percent in 2020, in line with the fiscal consolidation strategy to stabilize public debt. The overall fiscal deficit (including grants) jumped from 1.9 percent of GDP in 2016 to 3.0 percent in 2018 before declining to 2.5 percent in 2019. But COVID-19 led the deficit to expand to 4.7 percent in 2020. Revenue targets for 2020 were not met due to COVID-19 and postponed tax reforms.

Figure 2.7: Government revenue, spending, and budget deficits in Ethiopia, 2000-23



Source: IMF 2021b.

2.2.2 Fiscal Outlook

The fiscal outlook is positive, reflecting ongoing reforms. The fiscal deficit is expected to increase slightly to 5.6 percent of GDP in 2022 and 4.9 percent in 2023 because reforms to increase revenues were postponed due to COVID-19. At least 11.5 percent of the budget is financed from external sources (loans and grants) due to weak domestic revenue performance. Ongoing conflicts in northern Ethiopia of the country could increase public spending and further worsen the fiscal outlook. But ongoing liberalization—including sales of telecommunications licenses—is helping to mitigate some of these risks, at least in the short term.

2.2.3 Fiscal Reforms

Fiscal policy reforms remain central to achieving goals for national growth. Ethiopia's fiscal policy is geared toward promoting economic growth through large public investments in infrastructure, implying that continued high economic growth hinges on the ability to expand the resource base. As part of economic reforms, the government is taking steps to modernize the tax system including tax law and policy reforms (including to excise and value-added taxes and presumptive taxes on micro, small, and medium-size enterprises), introduction of biometric taxpayer identification numbers, institutional reorganization and work procedure development, and taxpayer education and awareness about tax responsibilities. Taxpayer identification numbers will make tax collection more efficient and effective by creating a database of taxpayers to control tax evasion. The system provides links to the ongoing computerization of tax operations. Federal, regional, and city administration taxpayers have been issued these numbers. Business process reforms focus on restructuring tax organs and tax administration to transform revenue mobilization, including by prioritizing tax audits and debt collections, establishing a Large Taxpayers Office, and strengthening information technology systems. Other measures include modernizing tax collection and improving public expenditure management. Operational measures focus on making tax administration fair, transparent, and accountable.

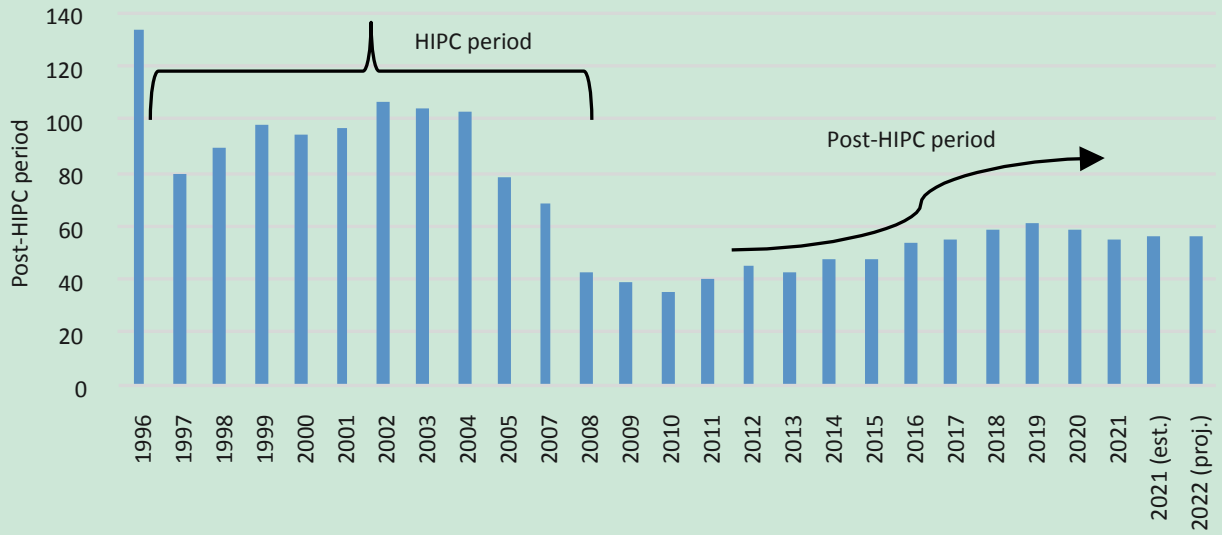
Challenges include capacity weaknesses, high staff turnover, low motivation, high cost of compliance, weak information technology systems and data management, and poor tax literacy. The fiscal consolidation strategy started in 2018 aims to reduce the growth of public debt, especially that due to borrowing by state-owned enterprises. Improvements are needed in the reach and quality of public spending to strengthen government effectiveness in fast-tracking poverty and inequality reduction. Though the public sector, including state enterprises, dominate the economy, the share of employment in the public sector is low. Public sector wages should be reviewed to ensure decent pay and thus enhance the effectiveness of public sector workers and reduce corruption.

2.3 Public Debt Policy and Management

Ethiopia's public and publicly guaranteed debt increased steadily after the Highly Indebted Poor Countries (HIPC) initiative ended in 2006. For 2021, public and publicly guaranteed debt was estimated at 56 percent of GDP (with external debt at 33 percent), almost the same as in 2020 (though with slightly higher external debt).[2] External debt peaked at 136 percent of GDP in 1996, then dropped to 35 percent in 2009 before picking up to 54 percent in 2015 following cancellation by creditors (figure 2.8). After rising during 2010-18, external debt grew at a slower pace in 2019-20 as capital inputs for infrastructure projects were scaled down. Going forward, public debt is projected to increase due to spending on health and other social services amid reduced public revenues.

[2] Total public and publicly guaranteed debt was estimated to be $55.6 billion at the end of June 2021, up from $54.9 billion in June 2020. External public and publicly guaranteed debt was $29.5 billion (about 53 percent of the total) in June 2021, up from $28.7 billion in June 2020 (FDRE 2021).

Figure 2.8: Public debt in Ethiopia, 1996-2022 (% of GDP)



Source: IMF 2021b.

2.3.1 Debt Sustainability and Risks

Ethiopia's debt profile is sustainable. The present value of public and publicly guaranteed debt to GDP was an estimated 20 percent in 2021 and is projected to remain under the threshold of 40 percent through 2025. Still, the risk of public debt distress is elevated because of borrowing to finance investment projects and slow export growth. Two external debt indicators—the present value of external debt-to-exports ratio and the debt service-to-revenue ratio—have breached their thresholds. In 2021 the ratio of external debt to exports was 254 percent, against the threshold of 180 percent, and is projected to remain above the threshold through 2024 (table 2.2). The ratio of debt service to exports was estimated to be 20 percent in 2021, compared with the threshold of 15 percent, and is projected to remain above the threshold past 2025. (The spike in the ratio of debt service to exports in 2025 is due to a 10-year $1 billion Eurobond that matures at the end of 2024.) These ratios highlight Ethiopia's growing debt challenge due to borrowing for public infrastructure investments and weak export performance. Still, the ratio of debt service to revenue was estimated to be 10.5 percent in 2021, compared with the threshold of 18 percent, and is projected to continue falling as tax reforms are implemented.

Table 2.2: Public and publicly guaranteed external debt indicators in Ethiopia, 2017-25 (Percent)

Type of indicator	2017	2018	2019	2020	2021(e)	2022(p)	2023(p)	2024(p)	2025(p)	Threshold
Solvency										
Present value debt/exports	280.9	247.9	247.6	247.3	254.4	231.8	212.4	196.0	176.9	180
Present value debt/GDP	21.9	21.4	19.6	17.7	20.0	21.5	22.0	20.9	18.7	40
Liquidity										
Debt service/exports	17.8	24.4	24.6	26.9	20.0	18.7	17.4	19.4	26.9	15
Debt service/revenue	9.1	16.4	16.8	15.2	10.5	9.6	9.4	10.9	16.2	18

Source: IMF 2020a.

The IMF and International Development Association (IDA) have categorized Ethiopia as being at high risk of debt distress based on weak export performance. But the present value of external debt-to-GDP is within the threshold, and growth in external debt as a share of GDP has tapered off. The IMF and the African Development Bank project that public debt will remain sustainable—although downside risks and liquidity pressures have increased. About three-quarters of outstanding external debt is official (mostly concessional from bilateral and multilateral lenders; box 2.2). The rest is owed to private creditors, including the Eurobond issued in 2014.

Box 2.2: Structure and drivers of Ethiopia's external debt

Most of Ethiopia's debt is owed to official sources, particularly multilateral creditors. In 2021, 77 percent of Ethiopia's outstanding external debt was owed to official creditors and 23 percent to private creditors, compared with 69 percent and 31 percent in 2016. A growing share of official debt is owed to multilateral creditors: 62 percent compared with 48 percent in 2016. In 2021 bilateral debt was 39 percent, down from 53 percent in 2016. External debt owed to Paris Club and non-Paris Club creditors amounted to 3.4 percent and 34.8 percent, respectively, in 2020—compared with 2.6 percent and 49.8 percent in 2016. Private sector debt (from commercial banks, suppliers, and a 2014 Eurobond) accounts for 12 percent of total debt.

China is an important creditor for Ethiopia, accounting for about one-quarter of external debt, much of it due to borrowing for infrastructure projects including roads, railways, and energy. Among China's biggest outlays in Ethiopia is a $2.5 billion loan from the Export-Import Bank of China for the construction of the railway between Addis Ababa and Djibouti.

Ethiopia has one sovereign Eurobond worth $1 billion, issued in 2014 and due in 2024. The Eurobond accounts for about 6 percent of external debt, signaling the small role of private creditors. Maturity of the bond in 2024 is projected to breach debt sustainability thresholds. Meanwhile, domestic bond financing has increased. In 2020 outstanding National Bank of Ethiopia bond claims on government and state enterprise corporate bonds amounted to about $5 billion and $10 billion (19 and 38 percent of domestic debt), respectively, up from $200 million and $7.5 billion (1 percent and 33 percent) in 2018. Ongoing public-private partnership projects are estimated at about $9 billion. The drivers of increased bond issues by the National Bank and state enterprises are deficit financing and strategic investments in manufacturing and services.

2.3.2 Debt Management Strategy

Since 2018 Ethiopia has been implementing reforms to return to a moderate risk of debt distress rating and create space to absorb shocks. The reforms have included a moratorium on nonconcessional external borrowing, fiscal consolidation to reduce the deficit and expand sources of public financing, and reprofiling of external loans to lower repayment costs. Public spending as a share of GDP dropped from 18.2 percent in 2017 to 14.2 percent in 2020, in line with the fiscal consolidation strategy to stabilize public debt. Efforts to expand exports have included promoting tourism and establishing industrial parks and agricultural processing zones. Companies engaged in exports—especially manufacturing—receive tax incentives and priority access to foreign currency. Steps

have also been taken to reduce all but the most crucial imported inputs for public investments.

Reforms are ongoing to open up sectors such as finance, telecommunications, and logistics to private sector participation. These moves are expected to further ease pressure on public spending and expand the tax base. The anticipated output diversification from infrastructure investments and industrial parks will improve Ethiopia's resilience and cushion against external shocks. The liberalization of Ethio Telcom and entry of Safaricom will accelerate growth in services and domestic revenue mobilization. Measures to improve economic and financial governance and diversify sources of public financing are expected to expand fiscal space. Tax administration reforms and system automation and enforcement are expected to boost revenue collection and efficiency.

The moratorium on nonconcessional external borrowing by the government and state enterprises has slowed debt accumulation. The government is engaging with creditors to discuss the reprofiling and rescheduling of existing debt payments. Capacity building is required in debt management, analysis, and transparency to support negotiations with creditors on debt reprofiling. The Asset and Liability Management Company, established in 2020, is helping to manage the residual debt of state enterprises. (In August 2021 the company absorbed $9 billion of debt owed to the Commercial Bank of Ethiopia by the Ethiopian Electric Power Corporation, Ethio-Engineering Group, Chemical Industry Corporation, Ethiopian Railways Corporation, Ethiopian Sugar Corporation, and the Metals & Engineering Corporation.) Between May 2020 and March 2021 the government saved almost $200 million through a temporary reprieve from the G20's Debt Service Suspension Initiative (DSSI). Ethiopia also applied for debt restructuring under the G20 Common Framework, but that led to sovereign credit rating downgrades: by Fitch from B to CCC and by S&P from B to B- in February 2021 and by Moody's from B2 to Caa1 in May and to Caa2 in October. In September 2021 the Creditor's Committee for debt restructuring under the G20 Common Framework was established, cochaired by China and France. It could help bolster investor confidence. The African Development Bank is providing technical support following Ethiopia's debt treatment request under the Common Framework.

2.4 Monetary Policy

2.4.1 Monetary Policy Goals and Tools

Ethiopia's goals for monetary policy are maintaining price and exchange rate stability and supporting sustainable economic growth. Monetary policy oscillates between accommodative and tight regimes in response to economic activity, fiscal deficits, and the need to contain inflation. The National Bank of Ethiopia mostly uses direct tools—particularly broad money supply (M2)—to reduce money supply when inflation is rising and vice versa. For example, during the 1990s low inflation was maintained by applying tight monetary policy. In 2019 tight monetary policy was pursued to contain inflation of 15.8 percent. In 2020 accommodative monetary policy was applied to stimulate economic activity, with the central bank providing about 0.5 percent of GDP in additional liquidity to private banks to facilitate debt restructuring—which raised broad money by 17 percent and inflation to 19 percent. Also in 2020, the broad money target grew by 17.0 percent due to a 23.6 percent surge in domestic credit, and accommodative monetary policy was used to mitigate the effects of COVID-19. Other monetary policy instruments, including reserve requirements, fixed deposit rates, interbank borrowing, credit control, and moral suasion, are applied to achieve key objectives. For example, in 2021 the statutory deposit ratio for foreign exchange receipts from exports, remittances, and aid was raised from 30 to 50 percent. Controlled interest rates and selective credit control are used to channel credit to the public sector. Progressive devaluation of the Ethiopian birr was sustained to support monetary policy.

Use of other monetary instruments (such as open market operations and standing facilities) has been limited by the underdeveloped securities market. Treasury bills and government bonds are the only securities issued to finance public spending or to absorb excess liquidity in the banking system. Interbank money market operations are nascent. But this is changing with the ongoing reforms. Standing facilities will mitigate against interest rate volatility and liquidity risks, thus deepening the financial sector. To prepare for more open market operations, yields on treasury bills are market-determined (rising from 1.7 percent in December 2019 to nearly 9.0 percent in September 2021), and a secondary market for government securities is in the offing. But no secondary

market exists for securities trading. In August 2021 the National Bank doubled the cash reserve ratio to 10 percent and raised its lending rate to commercial banks from 13 to 16 percent.

The National Bank's need to meet government requests for advances undermines its autonomy. Proclamation 206/1963 granted the bank autonomy, and Monetary and Banking Proclamation 83/1994 underscored its independence as the entity responsible for monetary policy and supervision of financial institutions. Article 25.2 of the latter proclamation underscores maintenance of monetary stability and balance of payments equilibrium as the bank's key roles. Though Article 25.3 set limits on government borrowing from the National Bank, Proclamation 591/2008 lifted those limits, limiting its orientation to price stability. The bank engages in direct and indirect fiscal operations by financing budget deficits and liquidity advances to the Commercial Bank of Ethiopia and the Development Bank of Ethiopia for loans to state enterprises. In addition, a few state enterprises (such as the Ethiopian Railway Corporation and Ethiopian Electric Power Corporation) and regional governments issue bonds.

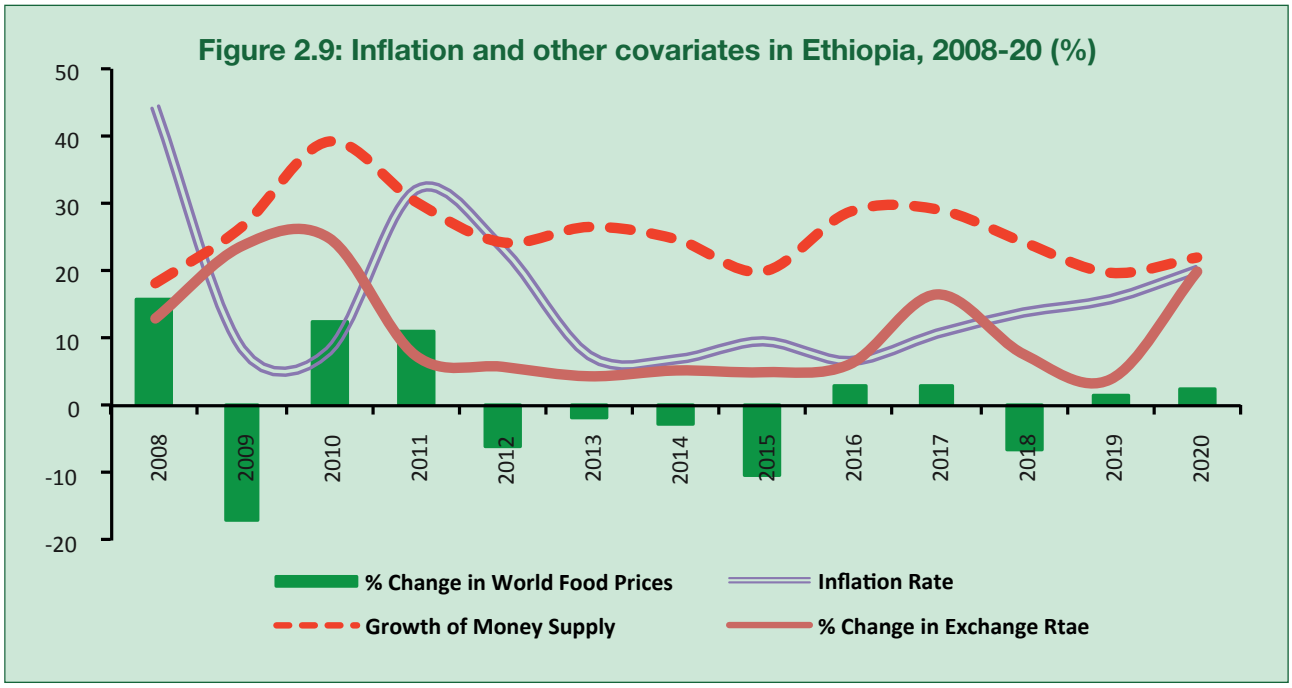
2.4.2 Monetary Policy Outlook

Tight monetary policy is expected in the short term to contain inflation from 21 percent in 2021 to within the target of 8 percent. In the medium term, accommodative monetary policy is expected to be pursued because it is critical for the authorities to effectively respond to infrastructure financing requirements and address the health and economic impacts of COVID-19, as well as post-conflict reconstruction requirements. The National Bank is reforming the banking industry, including by removing lending rate caps and minimum deposit rates as well as leveling the playing field in the industry. Increased use of policy-based instruments—including open market operations—will help mop up excess liquidity and keep inflation in check. A gradual transition to a market-based exchange rate will support monetary policy responses.

2.4.3 Effectiveness of Monetary Policy

Monetary policy is generally ineffective because of the use of direct control tools in the context of a fixed exchange rate regime. During 2010-19 inflation averaged 13.4 percent, with a high of 32.0 percent in 2011 and a low of 6.6 percent in 2016 (figure 2.9). In 2021 inflation reached 21.0 percent largely because of COVID-19 and structural constraints. The key drivers of inflation are food and nonalcoholic beverages, followed by nonfood items. In 2020 bread and cereals (28.3 percent), vegetables (27.4 percent), fruits (24.8 percent), and meat (24.3 percent) were the main sources of food inflation; for nonfood items they were transport (23.0 percent), housing, water, and electricity (19.4 percent), alcohol and beverages (18.2 percent), and hotels and restaurants (18.2 percent).

Inflation is driven by growth in money supply, fiscal deficit financing, and structural constraints. Shocks such as COVID-19, desert locust invasion, and insecurity add to the volatility of inflation. Inflation management requires introducing effective monetary policy and liquidity management tools to contain the growth of reserve money, reduce direct advances to the government, strengthen the National Bank's analytical capacity, and make supply chains and domestic commodity markets more efficient. An increased focus on monetary policy objectives (price stability and predictable policy rate) and independence of the central bank would make monetary policy more effective.



Source: National Bank of Ethiopia 2021.

Until 2003 the velocity of money was declining, after which it reversed and has since continuously grown. The broad money multiplier (broad money to reserve money) grew by an annual average of 4.7 percent during 2018-20. Given the rising money multiplier and declining velocity, corresponding money growth should be slower to stabilize price levels. The long-run elasticity of money supply is about 1.45, implying that a 1 percentage point change in the money supply leads to a 1.45 percent change in long-run inflation growth (Alemu, Mulugeta, and Wassie 2016). The interest rate channel of monetary policy is less effective in addressing long-run inflation due to financial repression that leads to rigidities in the financial market. To mitigate this problem, a combination of policy options and monetary transmission channels (including interest rates, credit, and exchange rate channels) is needed.

2.4.4 Exchange rate policy

Ethiopia follows a managed float exchange rate regime. According to the National Bank of Ethiopia, the nominal exchange rate is determined by the interbank market, with no predetermined path. The bank occasionally intervenes in the market on the buy or sell side based on trends in supply and demand. In September 2021 the birr officially traded at 45.3 to the U.S. dollar, a 29 percent depreciation relative to November 2020 and 65 percent since December 2019. Since 2012 the ETB has depreciated by about 7 percent a year against the dollar. Despite this progressive depreciation and measures to curb parallel markets, the gap between the official and parallel exchange rates remains at 20-25 percent, underscoring excess demand and the misaligned official rate. Investors, individuals, and institutions must wait as long as 12 months to access foreign currency.

The government is committed to a gradual transition to a market-clearing rate by 2022, under its three-year IMF program. Foreign exchange reform to correct for misalignment of the birr and gain flexibility in the exchange rate is expected to increase foreign exchange inflows from investors and remittances and thus eliminate foreign currency shortages. Gradual devaluation of the birr (by about 2 percent a month) has been underway since 2019 to transition toward a market-clearing rate and to support the effectiveness of monetary policy. In the second half of 2020 the National Bank issued new currency notes and imposed restrictions on cash transactions in an effort to curb the parallel foreign exchange market. In August 2021 the bank introduced a regulation to temporarily halt commercial bank loans for land, building, and

household items as another measure to curb the rush for foreign currency purchases.

The real effective exchange rate—a good measure of the country's competitiveness relative to its trade partners—depreciated by 10 percent in 2020 but remains overvalued by 12-18 percent. The current real effective exchange rate index is 163, about 6 percentage points above the past 10-year average (157) and 26 points above the past 20-year average (137), confirming the birr's overvaluation relative to historical norms.

2.4.5 Monetary Policy Reforms

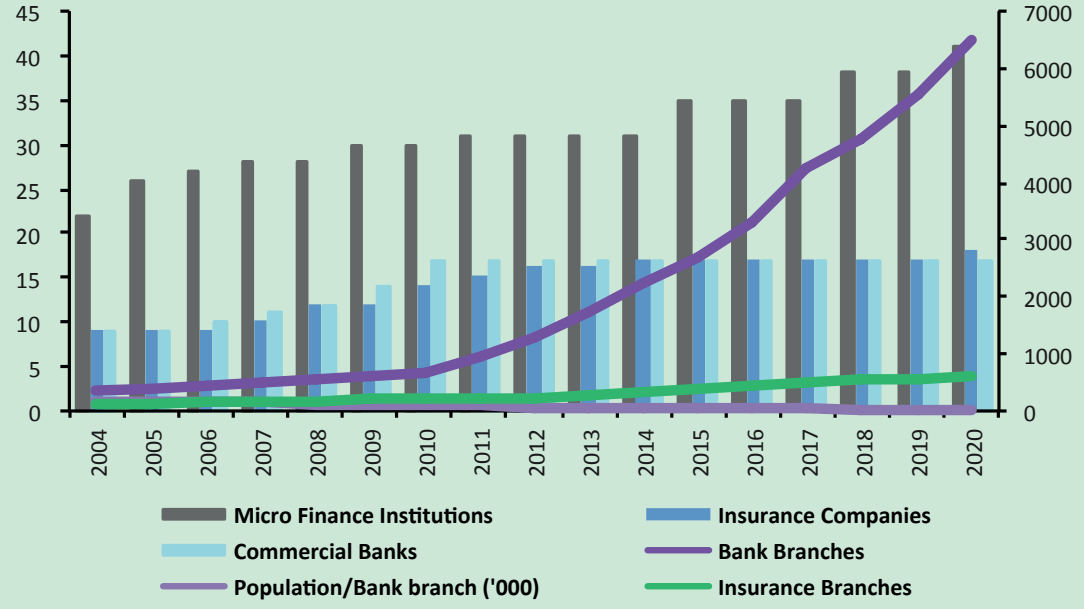
Ethiopia's Ten-Year Development Plan for 2021-30 lays out an ambitious monetary policy framework as a pathway to prosperity (FDRE 2021). Monetary policy is expected to stimulate economic growth while maintaining single-digit inflation. A shift to open market operations and other market-based monetary policy instruments is expected to strengthen monetary policy. The development of both the primary and secondary markets for government securities is expected to increase the private sector's appetite for securities and reduce government borrowing from the central bank to cover the fiscal deficit. A move toward a market-clearing exchange rate by the end of 2022 will allow the rate to more closely reflect Ethiopia's underlying macroeconomic fundamentals and potentially attract more foreign exchange inflows. Market-determined interest rates will be important for the financial sector to support the ongoing reforms.

51. An interbank money market and treasury bill auctions have been introduced and restrictions on lending interest rates relaxed. Key monetary policy reforms involve a shift from direct control tools—including minimum reserve requirements and restrictions on commercial bank lending—to indirect, more flexible monetary instruments such as open market operations. Treasury bill auctions, introduced in December 2019, increased yields to 7.0 percent in 2021 compared with 1.2 percent in 2019. The National Bank of Ethiopia is proposing to adopt the reserve requirement averaging approach to replace the current situation, where banks maintain 5 percent of their deposits on a continuous basis. A new liquidity forecasting framework is being developed based on government cashflows as the main input, whereas the current model calculates the total stocks for excess reserves for a week or a month.

2.5 Financial Markets

Ethiopia's financial sector is sound and profitable—though it is closed to international competition, which limits innovation and competition. In 2020 there were 17 commercial banks, 18 insurance companies, and 41 microfinance institutions (Figure 2.10). The banking industry accounts for 76 percent of the financial sector's capital, followed by microfinance institutions (15 percent) and insurance and leasing companies (9 percent). State-owned banks account for 35.3 percent of deposits and 63.7 percent of outstanding loans. In 2020 the number of bank branches reached 6,511 (with more than a third of them in Addis Ababa), and the bank branch to population ratio fell to 1:14,515. Insurance companies had 605 branches. Private insurance companies account for 71.7 percent of total capital. The 41 microfinance institutions served more than 2.3 million clients. But the financial sector is shallow and offers a limited range of financial products. Capital markets have yet to be developed and most lending is collateral-based, limiting access to credit. The government aims to strengthen financial stability while reorienting banks' activities to support the transition to a private sector-led economy.

Figure 2.10: Types and trends of financial institutions in Ethiopia, 2004-20



Source: National Bank of Ethiopia 2021.

2.5.1 Recent Financial Sector Developments

Despite being closed to international competition, Ethiopia's financial sector is undergoing many reforms. After the shift to market-determined treasury bill auctions in 2019, market participation by banks, insurance companies, and social security funds increased, resulting in greater competition and higher yields. In 2020 the value of treasury bills offered reached 231.5 billion birr ($4.49 billion) while the amount demanded was 242.2 billion birr and 4.6 percent oversubscription. Commercial banks accounted for 23.6 percent of investments in outstanding treasury bills and nonbank institutions for 76.4 percent.

Elimination of the 27 percent rule requiring private banks to buy five-year bonds from the National Bank was reflected in domestic credit growth of 22.1 percent in 2020, despite the impacts of COVID-19, compared with 22.3 percent in 2019. The share of adults with a bank account grew from 21.7 percent in 2014 to 35.0 percent in 2020 (World Bank 2021e). But financial inclusion remains low and gender inequalities persist. Only 29 percent of women have a bank account compared with 41 percent of men. The National Bank is implementing reforms to deepen financial markets and attract more long-term finance, especially from insurance companies, social security funds, and the private sector (see section 2.5.3).

2.5.2 Financial Sector Stability and Risks

55. The public sector dominates the financial sector, which underscores its stability and strong capitalization. Two state-owned banks—the Commercial Bank of Ethiopia and the Development Bank of Ethiopia—accounted for 56 percent of banking sector capital in 2020, up from 50 percent in 2016. The population to bank branch ratio improved from 27,932 in 2016 to 14,515 in March 2021. The share of nonperforming loans is low, at 2.6 percent, due to the dominance of the Commercial Bank and the offering of loan guarantees. As noted, the financial sector is closed to foreign competition (including banking, insurance, and other financial services), which impedes competition, innovation, and access to long-term credit.

Ethiopia's financial sector faces liquidity shortages (World Bank 2019b). In 2019 the ratio of gross savings to

GDP rose to 24 percent of GDP, up from 22 percent in 2016, while the ratio of investment to GDP remained at about 35 percent over the same period, underscoring the large gap between savings and investment. A phased approach to financial sector reforms is needed, guided by robust regulation that expands the reach of the financial sector and competition. The Financial Inclusion Strategy 2014-20 aims to increase financial intermediation and innovation and to promote new products including e-money.

2.5.3 Financial Sector Reforms

Several financial sector reforms are underway to increase financial intermediation efficiency, create dynamism in the sector, and contribute to private sector growth. The reforms aim to attract more long-term finance, especially from insurance firms, social security funds, and the private sector. These include measures to deepen money markets and create a functional framework for capital markets. The volume of treasury bills traded increased almost 300 percent during the first half of 2020 and are providing an alternative to financing the fiscal deficit through central bank advances. A transition toward a market-clearing foreign exchange regime and reforms to improve the business environment will help to expand the role of the private sector and attract foreign direct investment.

Key milestones include the introduction of biweekly treasury bill auctions in December 2019 and the Capital Market Proclamation in June 2021. Parliament passed the law to operationalize capital markets, paving the way for the development of a Capital Markets Authority, Ethiopia Stock Exchange, and dispute resolution mechanism. This important step will expand options for long-term financing for the private sector and could increase the tax base as well as economic activities and employment because it allows for the licensing of capital market intermediaries such as brokers, investment advisers, investment banks, and collective investment schemes.

Greater capital market participation by pension funds and insurance companies will help deepen long-term sources of capital for the private sector. Though these markets may start out small, they create new mechanisms through which private capital can be raised and more efficiently allocated. The National Bank of Ethiopia passed directives on open market operations and standing facilities in June 2021, paving the way for market-based monetary policy. The African Development Bank has supported these reforms. Reforms allowing participation by international banks would increase competition and innovation. Further support from developments is needed to strengthen capital market infrastructure, regulation, and operational capacity.

2.5.4 Efficiency of Financial Markets

Ethiopia's financial markets remain inefficient in part because of the dominance of one state-owned commercial bank and limited competition. The financial sector is dominated by commercial banks and a few insurance companies. The Development Bank of Ethiopia is the only development bank. The sector is closed to foreign competition in banking and insurance. These factors limit competition, which impedes efficiency, innovation, and wider access to long-term credit. The ongoing financial sector reforms, with a focus on money and capital markets development, will improve the sector's efficiency, financial intermediation and inclusion, and its contribution to economic growth. A phased approach to the reforms—while building a robust regulatory framework—is important to expand the financial sector's reach and competition.

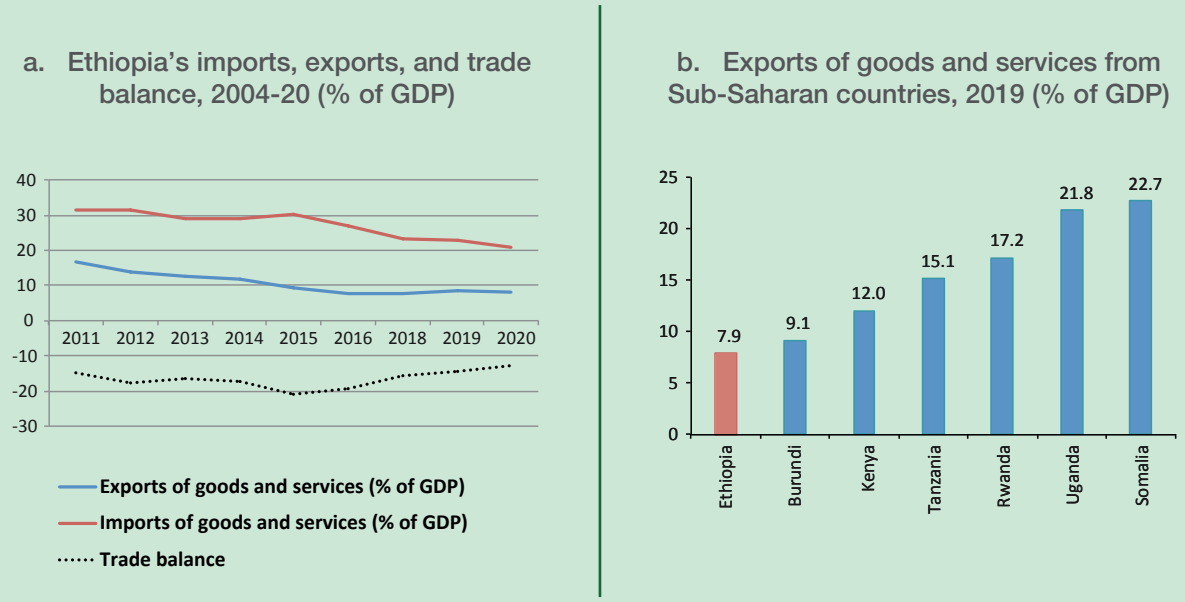
2.6 External Sector

2.6.1 Trends in the Current Account

Ethiopia has been running a current account deficit, driven by the low growth of merchandise exports. Lower imports and increased service exports improved the current account deficit from 6.5 percent of GDP in 2018 to 2.8 percent in 2020. But the current account deficit is estimated to have been 6.5 percent of GDP in 2021 and projected to remain the same in 2022, then rise to 5.0 percent in 2023 due to COVID-19 and ongoing conflict. The trade deficit reached 11.0 percent in 2020, reflecting the deterioration in merchandise exports. The current account deficit is partially offset by private remittances, official aid, and a surplus in services (underpinned by Ethiopian Airlines). Drivers of Ethiopia's trade deficits include dependence on unprocessed agricultural commodity exports and its narrow export base and limited overseas markets.

In 2020 Ethiopian exports accounted for 8 percent of GDP, less than half the 2004 contribution (figure 2.11a). The country's export performance compares poorly to that of Rwanda (22 percent), Uganda (17 percent), and the Sub-Saharan average (30 percent; Figure 2.11b). Ethiopia's exports are concentrated in 231 products, compared with 708 in Kenya and 2,802 in Vietnam. In addition to the narrow export base, performance has stagnated since 2013 due to deteriorating terms of trade and weak logistics support. Merchandise exports increased marginally from $3.0 billion in 2015 to $3.6 billion in 2021. Imports fell 3.3 percent a year during that period as part of a strategy to reduce the import content of infrastructure inputs and due to foreign exchange shortages.

Figure 2.11: Ethiopia's trade balance and exports in various Sub-Saharan countries

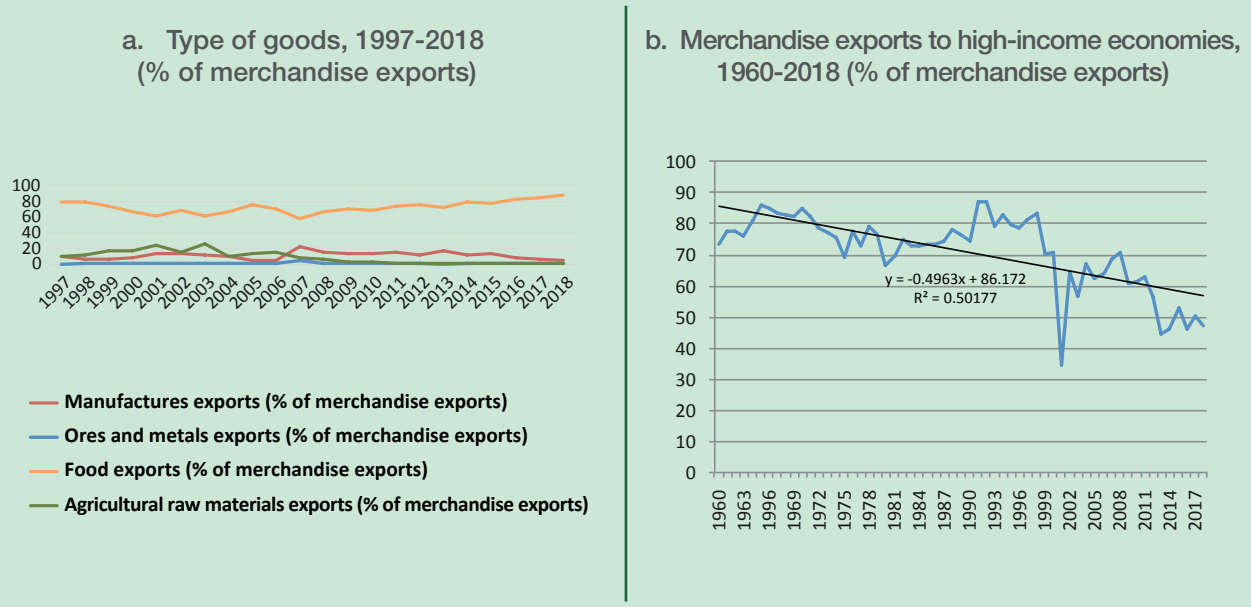


Source: IMF 2021b;World Bank 2021e.

The 2020 improvement in the trade deficit to 11.0 percent, compared with 21.0 percent in 2015—was due to the drop in imports (down 8.1 percent) and increase in exports (up 12.0 percent), despite COVID-19. Fiscal consolidation to curb external debt helped reduce imports, while favorable prices for gold, flowers, coffee, and chat helped revive exports. The current account balance also improved, by 12.0 percent in value and 1.1 percent of GDP. In 2020 remittances fell 10.2 percent, foreign direct investment 26.2 percent, and net official transfers 36.7 percent due to COVID-19 and conflict. The decline in foreign direct investment mostly affected infrastructure and manufacturing.

Poor trade performance is partly a reflection of the weak business environment and poor trade facilitation. Exports are dominated by commodities and agricultural products, with little domestic value addition. Manufactures as a share of exports rose from 5.5 percent in 2006 to 22.7 percent in 2007 but fell back to 5.6 percent in 2018 (figure 2.12a). Underpinned by Ethiopian Airlines, service exports account for 5 percent of GDP. While tourism accounts for nearly half of exports—up from 15 percent in the late 1990s—its revenues are highly vulnerable to political and health shocks such as COVID-19 and the conflict in Tigray. Falling export revenue inflows due to a decline in merchandise exports to high-income economies led to a deterioration in the balance of payments and exacerbated foreign currency shortages (figure 2.12b).

Figure 2.12: Characteristics of Ethiopia's merchandise exports



Source: World Bank 2021e.

Ethiopia's participation in world trade is low. Its ratio of exports to GDP is only 7.9 percent, compared with other land-locked African countries such as Rwanda (21.8 percent) and Uganda (17.2 percent; World Bank 2021e). Ethiopia is not a member of the World Trade Organization (WTO) or the East African Community (EAC), both of which could help increase its exports. But it is working toward becoming a member of the WTO. Increased engagement in international trade will support faster growth in GDP and total factor productivity because trade openness fosters investment and therefore greater productivity through technology spillovers and learning.

2.6.2 Current Account Outlook

The current account deficit is estimated to deteriorate to 6.2 percent of GDP in 2021 before improving to 5.3 percent in 2022 as service exports—led by Ethiopian Airlines—pick up. Export growth is expected to improve in the medium term as ongoing investments in industrial parks and integrated agro-industrial parks—as well as enabling infrastructure like the Addis-Djibouti railway and increased energy generation—support manufacturing exports and trade. For instance, Ethiopia's installed energy capacity is projected to increase substantially once the 9,200-megawatt energy plants that are under construction are completed, including the Grand Ethiopian Renaissance Dam (GERD). This increase has the potential to generate more than $1 billion in energy exports. In addition, the reduction of import-intensive public infrastructure inputs is expected to contain import growth.

Export performance is constrained by unreliable electricity supply, limited access to credit, weak raw material supply, and inefficient business environment and trade logistics. Tensions in global trade relations and the associated risks (such as increased protectionism) could reduce Ethiopia's access to external markets. Ethiopia enjoys duty-free and preferential market access to Australia, Canada, China, the European Union, and the United States, among others. Given that Ethiopia reaches less than 2 percent of all markets for the products it exports (compared with 11.3 percent FOR Vietnam), protectionism could further constrain external markets. Trade barriers and rising geopolitical tensions,

including Brexit-related risks, could slow growth in advanced economies including China and the Euro area—both among Ethiopia's top trade partners. Volatility in international commodity prices is a key downside risk for Ethiopia given its reliance on agricultural commodity exports. Subdued forecasts for growth present downside risks for commodity prices. Whereas lower oil prices will likely improve Ethiopia's fiscal and external balances, weak commodity prices will negatively affect its current account balance and potentially increase debt vulnerabilities.

2.6.3 Financing the Current Account Balance

The current account deficit is mainly financed using official flows including official borrowing. In 2020 foreign direct investment fell nearly 20 percent and remittances 10 percent, to 2.2 percent and 5.3 percent of GDP, reflecting the global economic slowdown, especially in Europe and the United States. New disbursements of grants and loans increased almost 72 percent, financing the current account deficit and compensating for lower foreign direct investment and remittances. Gross reserves fell to $3.1 billion in 2020 (from $3.4 billion in 2019), equivalent to 1.8 months of import cover. Over the past 10 years the net exports gap has widened to an annual deficit of 15.8 percent, mainly due to lack of diversification, low productive capacity, and gaps in infrastructure and logistics.

2.6.4 Balance of Payments

The balance of payments deteriorated from a deficit of $924 million (1.0 percent of GDP) in 2019 to $1.1 billion (1.1 percent of GDP) in 2020. Exports moderated to $2.8 billion in 2018 from an annual average of $3.0 billion during 2015-17. In 2021 total exports are expected to increase to $7.8 billion, from $7.4 billion in 2019. Merchandise imports dropped to $9.2 billion in 2020 from an annual average of $16.5 billion during 2015-17. Total imports are expected to increase to $23.7 billion in 2021 as a result of the increased deficit and the need for COVID-19 test kits and vaccinations.

The capital and financial account balance improved from 3.9 percent of GDP in 2017 to 5.2 percent in 2019 because foreign direct investment rose from $18.9 million in 2017 to $24.9 billion in 2019. The 2020 balance of payments deficit was covered by a $200 million drawdown of reserves and accumulation of net foreign exchange liabilities of about $700 million. A balance of payments surplus is expected in 2021, reflecting lower trade and current account deficits due to strong export growth and airline revenue, remittances, and lower imports (down 10 percent). The capital account will benefit from loan inflows, forecast at $1.1 billion, and more than $3.0 billion in foreign direct investment. Gross official reserves have remained low at about $3 billion since 2017 and account for only 1.8 months of imports.

2.7 Economic Prospects, Challenges, and Risks

2.7.1 Prospects

Sustained macroeconomic stability would ensure Ethiopia's ability to meet its growth goals and improved supply-side performance. Maintaining macroeconomic stability and accelerating reforms are critical to unlocking the private sector for job creation and inclusive growth. Sound economic policies will send clear signals to the private sector. Controlling inflation and improving the business environment are important to maintaining competitiveness. Improving labor productivity and cushioning poor and vulnerable people against shocks are crucial for sustained, inclusive growth. To benefit from the potential demographic dividend, Ethiopia needs to improve the quality of learning and skills acquisition, access to technology, entrepreneurship among young people, and access to finance. Measures to cultivate regional and international competitiveness—including making business and industrial reforms and addressing fiscal risks—are needed to accelerate Ethiopia's move to being a middle-income country.

As its first pillar, the Ten-Year Development Plan for 2021-30 underscores the quality of economic growth and shared prosperity. Economic growth is projected to remain at an average of about 10.0 percent a year. Structural transformation is expected to proceed steadily, with the shares of agriculture reaching 22.0 percent, industry 35.5 percent, and services 42.5 percent by 2030. This growth will be supported by other pillars including economic productivity and competitiveness, technological capability and a digital economy, sustainable development financing, private sector-led economic

growth, a resilient green economy, institutional transformation, gender and social inclusion, access to justice and efficient civil services, and regional peace-building and economic integration. Key elements of the Ten-Year Development Plan are summarized in annex 1.

2.7.2 Challenges

Ethiopia's public sector-led growth model largely financed by external borrowing has led to macroeconomic challenges, including foreign currency scarcity, increasing debt and inflation pressures, a mounting current account deficit, poor merchandise export performance, youth unemployment, inequitable income distribution, and geographic imbalances in the distribution of infrastructure and investments. Since the 1990s inflation has been increasing and volatile despite various monetary and fiscal policies. The growth registered over the past 15 years has not translated into increased job opportunities. Though poverty has been declining since 1996, inequality has increased since 2011. Unemployment, especially among urban youth, is also increasing (FDRE 2021).

2.7.3 Risks

The high risk of external debt distress threatens macroeconomic stability. In June 2021 total public debt was about $55 billion (50.0 percent of GDP), with external debt accounting for more than half of it (27.3 percent of GDP). Since 2017 Ethiopia has been classified as being at high risk of public debt distress due to weak export performance coupled with increased import-intensive public infrastructure investments. The high risk of external debt distress increases Ethiopia's susceptibility to shocks and discourage foreign investment. The IMF's 2019 debt sustainability analysis estimated the net present value of debt to exports at 247.6 percent and debt service to exports at 24.6 percent—well above the thresholds of 180 percent and 15 percent. Any further expansion of public debt could constrain the fiscal space and lead to repayment risks, especially as Ethiopia's $1 billion Eurobond comes due in December 2024.

Ethiopia's controlled exchange rate and overvalued local currency risk distorting prices of tradable relative to non-tradable goods, negatively affecting the composition of growth. In addition, the appreciated exchange rate impairs the relative incomes and purchasing power of poor people. A move toward a market-clearing exchange rate will reflect the true value of the birr. To narrow the exchange rate risks associated with exchange rate volatility, Ethiopia could build its reserves by expanding and diversifying its exports and potentially using the Special Drawing Rights recently allocated by the IMF.

CHAPTER: 3

CROSS-CUTTING ISSUES

To achieve long-term, sustained, equitable economic growth, Ethiopia must first address a multitude of cross-cutting issues including economic governance, climate change and green growth, gender disparities, fragility, private sector development, sustainable urban development, and civil society engagement. This chapter addresses each of these in turn.

3.1 Economic and Financial Governance

The 1995 Constitution is Ethiopia's supreme law, forming the basis for all other laws including state law, customary practice, and decisions of state organs. Article 61 of the Constitution vests legislative authority in a bicameral parliamentary system consisting of an upper chamber, the House of Federation (112 members), and a lower chamber, the House of Peoples' Representatives (547 members). Elections for these offices are held every five years. Ethiopia has experienced three major systems of governance in the past nine decades including a monarchy under Emperor Haile Selassie (1930-1974), a military dictatorship that governed under a socialist approach (1974-1991), and a federal system that since 1991 has taken a government-led approach.

3.1.1 Broad Measures of Governance and Stability

Ethiopia's ranking on the Mo Ibrahim Index of African Governance improved from 35th of 54 countries in 2018 to 31st in 2020 (IIAG 2020). The country's score improved marginally to 46.6 (of 100) in 2019 from 46.5 in 2018 but remained below Africa's average score of 49.9. The overall score improved by 6.7 percentage points during 2011-20, reflecting ongoing reforms. Performance on safety and the rule of law jumped from 41.8 to 47.9, participation and human rights rose from 33.9 to 34.8, and human development moved from 53.2 to 54.0. But sustainable economic opportunity declined from 50.9 to 49.7. According to the 2020 Worldwide Governance Indicators (WGI), Ethiopia remained below the 40th percentile in its six dimensions of governance, with half (regulatory quality, political stability and the absence of violence, voice and accountability) below the 20th percentile rank and the Sub-Saharan average (World Bank 2021f). These low rankings reduce investor confidence, with adverse implications for growth.

On political stability and the absence of violence, Ethiopia compares less favorably with its East African peers and the continent as a whole. According to the World Bank's World Development Indicators 2020, Ethiopia ranked below the 10th percentile on political stability and the absence of violence. Border conflicts with regional states contribute to this finding. Since 2018 improvements in freedom of expression have stoked ethnic sentiments and conflict, resulting in displacements and deaths. Tensions with Egypt over the dam on the Blue Nile remain a concern. Several years since Ethiopia and Eritrea signed their peace agreement, some issues remain and borders are still fortified. Historical grievances, especially in border areas, have not been sufficiently addressed—leading to occasional tensions and spikes in violence.

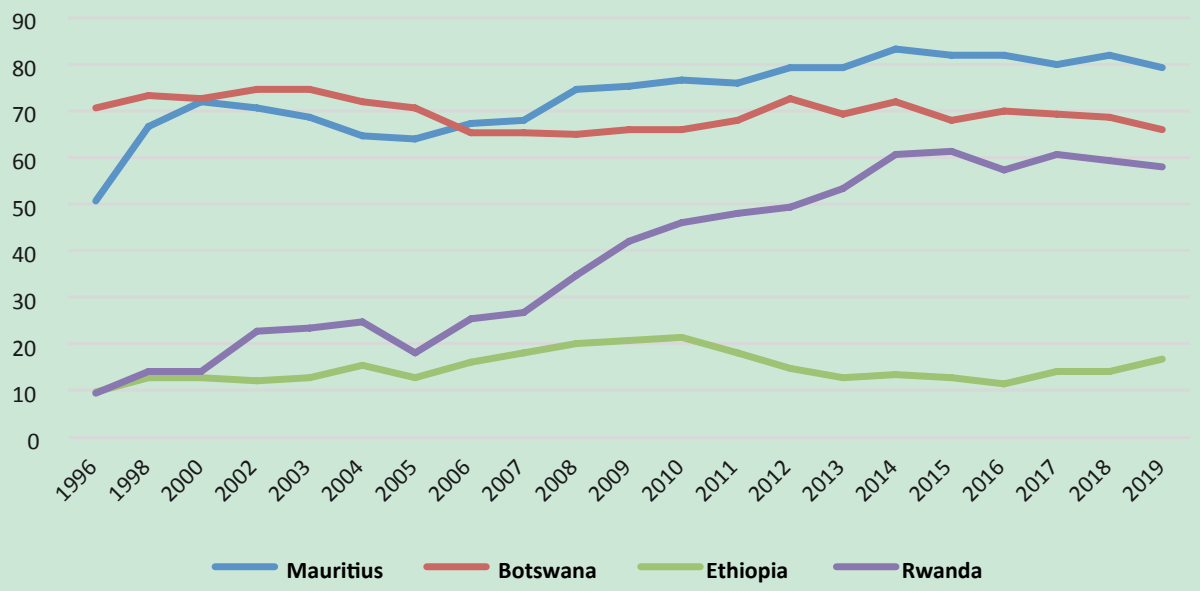
The ongoing conflict in the Tigray region underscores the need to strengthen social cohesion by improving political

governance and addressing causes of violence. During 2020-21 Ethiopia experienced escalations of longstanding grievances and increased polarization over historical issues about politics and identity, leading to ethnic-based violence in parts of the country. Rankings on voice and accountability have remained below the 20th percentile for the past two decades (World Bank 2021f). Although the Constitution guarantees freedom of assembly, association, and expression, there are restrictions. Since early 2018 the government has taken steps to strengthen free media and freedom of association and speech, including by revising laws on the media and civil society.

The Mo Ibrahim Index of African Governance ranks Ethiopia below the 40th percentile on the rule of law, and worse on access to justice and the independence and transparency of the judiciary. The African Development Bank's Country Resilience and Fragility Assessment also notes a rise in the incidence of intercommunal conflict. In the Bank's 2020 Country Resilience and Fragility Assessment, Ethiopia scored 4.6 (of 6.0) on political participation and 4.2 on political representation, compared with 5.7 and 4.1 in 2018. Scores on political stability, social cohesion, and security are low, at 3.7, 2.7, and 2.6.

Better governance would support inclusive growth through efficient and effective public services, human capital accumulation, better credit ratings, and increased investment. Ethiopia's rankings on regulatory quality have been below 20th percentile since 1995 and deteriorated since 2010, to 16.8 percent in 2019 (figure 3.1). Though corruption is not considered deeply entrenched in Ethiopia, the perception of it has increased in recent years. The Ethics and Anti-Corruption Commission has prosecuted some high-ranking government officials, yet its integrity and capacity to combat corruption need strengthening. The fight against corruption is a top government priority because corruption impedes development—reducing job opportunities and revenue mobilization—and exacerbates income inequality (Transparency International 2020). Ethiopia ranked 94th of 180 countries on Transparency International's Corruption Perception Index 2020 with a score of 38 (of 100), higher than the African average of 32 and up from 107th in 2017.

Figure 3.1: Rankings of regulatory quality in Ethiopia and peer countries, 1996-2019



Source: World Bank 2021e.

Public financial management has improved sustainably in the last decade. According to the 2019 Public Expenditure and Financial Accountability assessment, Ethiopia's fiscal discipline is satisfactory (World Bank 2020c). Links between national medium-term priorities and sector strategies are strong and well-defined in annual budgets. But flouting of procurement and asset management laws and regulations undermines fiscal discipline. Frequent in-year budget reallocations across sectors curb efficient resource allocation, indicating poor planning. Weak management of state enterprises—especially inadequate monitoring of fiscal risks and lack of timely reporting—curb fiscal discipline. Management responses to internal control issues have not improved. The inequitable allocation of grants by both the House of Federation and regional governments is also a concern. Delays in project implementation and the existence of off-budget funds hurt resource allocation and service delivery.

3.1.2 The Bank's Assessment

The government is implementing reforms to improve institutional performance and financial management to make governance more effective and minimize avenues for corruption. Ethiopia has revised its legal framework to strengthen public financial management and financial accountability. The office of the Federal Auditor General was established in 2012. The 2009 Procurement and Property Administration Act guides public procurement. Proclamation 847/2014 established the Accounting and Auditing Board of Ethiopia as the steward for reforms in public financial management. Yet the board's operational efficiency is weak. The 2019 Public Expenditure and Financial Accountability assessment indicated a deterioration in seven performance indicators over 2015. This deterioration manifested across all indicators, highlighting the need for continued reforms. Ethiopia needs to improve its accountability and anticorruption efforts to enhance public sector efficiency.

3.1.3 Governance of State-owned Enterprises

State enterprises are an integral part of Ethiopia's public sector-led growth model. In 2021 about 130 state enterprises provided both public and private goods and services in key sectors such as industry, construction, finance, telecommunications, trade logistics, transportation, and energy—often at tariffs below cost or investment levels. Because of their monopolistic protection and interlinked operations in key economic sectors, these enterprises are associated with high inefficiency and state capture. Their regulatory and accountability frameworks are blurred because many are managed as public service institutions and others under different laws. For example, state enterprises whose functions involve providing public services are governed by the Public Enterprises Proclamation 25/1992, while those with limited public functions are regulated by the Commercial Code. Most state enterprises have priority access to foreign currency and credit, resulting in unfair competition with the private sector.

Many state enterprises are inefficient, holding back the national goal of sustained economic growth underpinned by a vibrant public sector. In a 2018 survey, more than three-quarters of respondents reported corruption as a significant factor in doing business (ECCSA 2018).[3] Moreover, a significant portion of enterprises are concentrated in the hands of political elites, resulting in collusion between powerful groups operating from outside and within the government. As a result, policy reforms designed to improve governance and tackle corruption encounter resistance.

3.1.4 Public Procurement Reforms

Public procurement and property administration are governed by a number of laws and directives. These include the Federal Government Procurement and Property Administration Proclamation 649/2009, Public Procurement

[3] Financed by the Ethiopian Chamber of Commerce and Sectoral Associations; covered a sample of 200 private sector players.

and Property Administration Directive (2010), Public Procurement Manual (2011), and Standard Bidding Documents (updated in 2018). The Procurement Proclamation was revised and enriched with the findings of the second Methodology for Assessing Procurement Systems (MAPS II). This was approved by the Council of Ministers and is awaiting ratification by the House of Peoples' Representatives. The MAPS II final report was validated by stakeholders in December 2020.

Progress on e-government procurement is encouraging, with software development and a pilot test having commenced in July 2021. Professionalization of the procurement cadre is ongoing, with five rounds of training provided to 985 experts (627 men and 358 women). But staff turnover after certification remains a challenge. Key performance indicators are implemented in 10 regions, each with 5 bureaus and 1 City Administration, with b Bureaus, as well as 8 federal budgetary institutions.

3.1.5 Policy Options for Improving Economic and Financial Governance

Reform of state enterprise governance were initiated in 2018 to streamline operations and financial management as well as pursue liberalization. The goal is to transform and partially privatize strategic state enterprises and fully divest from nonstrategic ones to improve economic efficiency and reduce debt accumulation. Established in 2018, the Public Enterprises Holdings and Administration Agency (PEHAA) aims to improve state enterprises' management, financial reporting, and transparency through the adoption of international financial reporting standards, especially for enterprises to be privatized immediately. Better compilation of financial performance data for all state enterprises will address contingent liabilities. The Asset and Liability Management Company (ALMC), established in 2020, is consolidating the residual debt that state enterprises owe to the Central Bank and external lenders.

A review of state enterprises engaged in telecommunications, logistics and railways, industrial parks, sugar, and energy was completed in 2020—paving the way for their liberalization. The liberalization of Ethio-Telecom and licensing of additional telecom companies are ongoing. In May 2021 the government awarded an $850 million license to the Global Partnership for Ethiopia to operate a second telecom company. In 2020 a review of the financing and business model of the Development Bank was completed to address its high nonperforming loans and improve its financial standing for long-term sustainability. The transition from a mostly state-led to a private sector-led economy requires oversight. Strengthening capacity and addressing skills gaps are needed for governance and oversight institutions to play effective roles in support of inclusive growth and domestic resource mobilization. In addition, coordination with nonstate actors—including political parties, civil society, and the private sector—is needed.

3.2 Climate Change and Green Growth

3.2.1 Extent of Climate Change

Ethiopia's climate is diverse and vulnerable to changes. The climate ranges from equatorial rainforest with high humidity and rainfall in the south and southwest, to Afro-alpine on the summits of the Semen and Bale mountains, to desert-like conditions in the Eastern rim, including the lowlands (World Bank 2021a). Much of the country experiences a rainy season during June-September and a dry season in October-May. Variations in the length and intensity of each season are influenced by movements of the Inter-Tropical Convergence Zone (ITCZ), which is sensitive to variations in sea surface temperatures and differences in altitude. Increased sea surface temperatures in the Indian Ocean due to global warming and the ITCZ influence the onset and variation of rainfall patterns. Temperatures vary by region, with the lowland areas of the southeast and northeast experiencing 25-30oC and the central highlands experiencing 15-25oC.

Climate change affects key sectors including agriculture, health, and energy generation. High poverty, weak infrastructure, low adaptive capacity, and food insecurity exacerbate the effects of climate change. A major effect of climate change is increased food insecurity and malnutrition because of dependence on rainfed agriculture, with only 1 percent of cultivated land under irrigation. Droughts, floods, and land degradation result in crop and livestock losses, and rising temperatures increase evapotranspiration and loss of soil moisture, providing ideal conditions for pests and diseases.

Lower-than-expected rainfall in late 2020 and early 2021 contributed to high food insecurity in much of eastern and central Ethiopia. In 2011 the Horn of Africa drought left more than 4.5 million people in need of food assistance (World Bank 2021e). Livestock, which accounts for 20 percent of agricultural GDP, is vulnerable to the impacts of climate change on pasture and water availability.[4]

Recurring droughts pose the biggest climate-related risk to Ethiopia; eight major droughts—five of which resulted in famine—have been experienced since the 1980s. According to the Famine Early Warning Systems Network (FEWS NET), Integrated Food Security Phase Classification level 3 is projected for Tigray's Western Zone, Oromia's Borana Zone, and Sidama while IPC level 2 is projected for parts of Amhara's East Gojam Zone (FEWS NET 2021). In some areas higher rainfall increases the prevalence of malaria due to the spread of mosquitoes. The energy sector faces the risk of fluctuations in electricity production due to increased evapotranspiration and reduced rainfall. It is projected that by 2050, the volume of water flow on several tributaries of the Blue Nile will be 30 percent lower, reducing electricity generation capacity.

3.2.2 Transition to Low-carbon Development

Ethiopia has committed to a low-carbon development path through various national and sector strategies and the adoption of international protocols and multilateral environmental agreements such as the Paris Agreement of 2015. Ethiopia has ratified the United Nations Framework Convention on Climate Change (UNFCCC), Kyoto Protocol, Rotterdam Convention, and Stockholm Convention. Most of the principles and provisions in these agreements are addressed in national environmental policies and regulations. Ethiopia has submitted its First and Second National Communication to the UNFCCC. As part of its commitment to the Paris Agreement, Ethiopia submitted its intended Nationally Determined Contribution (NDC) in 2015. In 2007 it submitted its National Adaptation Program of Action (NAPA), and in 2010 it developed its Nationally Appropriate Mitigation Actions (NAMAs). The 2011 Climate Resilient Green Economy (CRGE) strategy guides national efforts to build a green economy (FDRE 2011). It seeks to advance development while reducing greenhouse gas emissions. The plan focuses on crop agriculture and livestock, forestry, renewable energy, transport, industry, and building construction.

The national target for greenhouse gas emissions is to fall below 145 metric tons of carbon dioxide equivalent (MtCO2e) by 2030, or a 64 percent reduction from the business-as-usual scenario. Following the conventional pathway, greenhouse gas emissions are estimated to increase from 150 MtCO2e in 2010 to more than 400 $MtCO^2e$ by 2030 (FDRE 2011). The CRGE strategy, with a technical secretariat housed in the Environment, Forest, and Climate Change Commission, provides the framework for Ethiopia to cut its net greenhouse gas emissions and achieve its vision of a low-carbon middle-income economy by 2025. Adopted in support of realizing Ethiopia's NDC, the strategy aims to strengthen national capacity to adapt to the impacts of climate change. It focuses on improving crop and livestock production, reestablishing forests, expanding renewable energy generation for domestic and regional markets, and using modern, energy-efficient technology in different sectors.

To achieve its green economy targets, Ethiopia is expanding renewable energy sources for electricity generation. Hydropower potential is estimated at 40 gigawatts and geothermal at 5,000 megawatts. The Grand Ethiopian Renaissance Dam (GERD) is expected to generate about 6,000 megawatts of electricity for domestic consumption and export. With Bank financing, power interconnection lines are being built between Ethiopia and Djibouti and between Ethiopia and Kenya. These lines are expected to expand domestic supply and exports to neighboring countries. Ethiopia has implemented the Intended Nationally Determined Contributions (INDCs) to reduce its vulnerability to drought and flooding. The government is implementing an Agriculture and Forestry Climate Resilience Strategy and Water and Energy Climate Resilience Strategy to guide investments in agriculture, fores-

[4] Ethiopia's livestock sector is the largest in East Africa, and globally, Ethiopia is the 10th largest livestock producer.

try, energy, water, and irrigation. Government commitment to financing renewable energy projects is demonstrated by undertakings such as the GERD, which is funded using domestic resources including sales of bonds.

To mitigate the impact of drought, drought-resistant crop varieties suitable for different agricultural areas are being introduced. Efforts are being made to improve water harvesting, build dams, and manage streams to increase water availability for people and livestock. In addition, steps are being taken to afforest degraded areas and improve economic opportunities in agroforestry, irrigation systems, and water use efficiency. Water-saving technology is being implemented and better wastewater treatment infrastructure is being built in urban areas to sustain water supplies. These measures will raise agricultural productivity and enhance food and nutrition security and water supply. Biodiversity movement corridors are being established to enable movement of plant and animal species to areas suitable for their survival in times of temperature increases. Strategies to mitigate the effects of floods includes strengthening infrastructure and dams, rehabilitating forests and degraded land, and increasing resilience to extreme weather events. Additional dams and power stations will increase electricity generation. Climate change-compatible codes for building construction and transport and water infrastructure will be implemented to minimize damage during floods.

Though Ethiopia is broadly on track to achieve its climate change goals, environmental safeguards need to be integrated with investment laws. For example, Proclamation 769/2012 covers only the application, issuance, renewal, and promotion of investment; compliance with environmental standards and undertaking environmental impact assessments are not explicitly included as requirements for applying and issuing investment permits. Better coordination is needed between investment and environmental entities to ensure that investors acquire environmental permits as a prerequisite for investment permits. Increased capacity to mobilize financing for climate action is needed to raise some $200 billion to achieve green economy targets by 2030 (FDRE 2011).

The desire to achieve middle-income status by 2025 and ongoing industrialization could result in increased emissions. Engagement and coordination with development partners—such as the African Development Bank and United Nations—are needed to harmonize environmental policies for optimal outcomes. The Bank's operational policies for social and environmental safeguards are incapsulated in its integrated safeguards systems. Operational safeguards will be applied in all projects to avoid adverse impacts on the environment and affected people while maximizing potential development benefits to the extent possible; to mitigate and/or compensate for adverse impacts on the environment and affected people; and to strengthen gender-responsive safeguards and develop capacity for managing environmental, social, and gender-related risks and impacts.

Relevant ministries and institutions need the Bank's technical support to enhance prospects for accessing climate finance resources. Support for developing proposals will help access resources such as the Green Climate Fund, Global Environment Facility, and Climate Adaptation Fund. The Bank should provide technical assistance to relevant ministries to monitor and evaluate the extent of climate change mainstreaming and implementation of its national and sector policies and strategies. The Bank could sustain its support for the development of other sources of renewable energy including solar, wind, and geothermal as well as additional interconnections to help reduce excess reliance on hydropower.

3.2.3 Inclusive, Green Growth

Ethiopia's growth has been relatively inclusive, underscored by highly pro-poor public spending. But income, spatial, and gender inequalities remain in access to basic services, opportunities, and development outcomes (WEF 2021). For example, poverty is higher in lowland areas (Somali, Afar, Gambella, parts of Oromia and the SNNP region) than in highlands due to historical marginalization in politics and in access to markets, finance, and industrialization opportunities. Spatial marginalization is partly due to limited road access and the arid climate of lowlands. Lowlands are sparsely populated, which implies that services cost more to provide. Highlands with better road connectivity and electricity supply have experienced faster growth.

The CRGE strategy and Agriculture and Forestry Climate Resilience Strategy 2011-25 are the blueprints for Ethiopia's

green growth and zero net emissions. The CRGE strategy aims to reduce greenhouse gas emissions from different sectors and vulnerability to climate change while promoting gender-responsive economic growth (see annex 2). It seeks to strengthen national capacity to adapt to the impacts of climate change and defines the institutional framework and procedures for mitigating current and potential social and environmental risks from development programs, the mechanisms for public consultation, and the disclosure of project information as well as for addressing grievances during project implementation.

Increased investments in and use of renewable energy are among the key interventions to achieve green growth. Ethiopia's 1997 Environmental Policy seeks to promote sustainable social and economic development through conservation and sustainable use of natural, humanmade, and cultural resources to improve the quality of life of today's generations without compromising the ability of future generations to meet their needs. The policy includes harmonizing and mainstreaming environmental issues in sectoral and cross-sectoral policies.

Despite progress, economic participation by women is hindered by gender inequalities arising from unfavorable social cultural norms, practices, and stereotypes. In addition to their work in agriculture, women are socially assigned the task of safeguarding and tending to their family's basic needs through the provision of food, health, and hygiene. They are responsible for cooking, collecting water, taking care of children and the elderly, and gathering fuel wood for household consumption and income generation. Thus women bear a disproportionate work burden, leading to time poverty and mobility constraints. Rural women's long working hours correlate to a triple work burden in the productive, reproductive, and social spheres. Women's work is mostly unpaid and unrecognized, as is their well-being.

3.3 Gender Disparities

Women make up almost 51 percent of Ethiopia's population and head 26 percent of households (37 percent in urban areas). Ethiopia is among the world's most improved countries in shrinking gender gaps, thanks to measures to advance equal opportunities (WEF 2020b). Between 2010 and 2020 Ethiopia's ranking on the Gender Gap Index improved from 121st of 134 countries to 97th of 156. In 2019 Ethiopia scored 0.487 on the Bank's Africa Gender Index compared with Africa's average of 0.484.

In 2018 Ethiopia became one of the few countries in the world with a cabinet half comprised of women—along with a female head of state, president of the Federal Supreme Court, and chair of the National Electoral Board. Women's representation in the House of Peoples' Representatives rose from 28 percent in 2010 to 39 percent in 2015. Women's representation in regional councils also increased but is still lower than at the federal level.

Progress has been made on advancing gender parity in primary school enrollments, improving maternal health, and reducing the prevalence of female genital mutilation and child marriages (FDRE 2021). Women's health outcomes are improving, supported by the Health Sector Transformation Plan 2016-20 and Reproductive Health Strategy 2006-15.

Gender equality is enshrined in the 1995 Constitution, which underscores access to opportunities and public social services for all and enshrines the principle of inclusion. The federal government must allocate resources equally and protect the most vulnerable groups. Several policy and legal initiatives have been designed to promote gender equality and equity. The 1993 Women's Policy and 2016 Women's Development Package provide a framework for gender equality, with provisions on affirmative action for women to participate in public programs. In 2000 the Family Code was revised to ensure women's equal rights to assets in marriage. Ethiopia is a signatory to the UN Convention on the Elimination of All Forms of Discrimination Against Women, and the Ministry of Women, Children, and Youth Affairs is at the fore of mainstreaming gender equality.

Gender mainstreaming is central to the national development agenda and features in key development strategies such as the Ten-Year Development Plan 2021-30 and its predecessor, Growth and Transformation Plans I and II (GTP I and II). GTP I and II had standalone pillars on women and youth empowerment plans; Proclamation 1097/2018 requires all public institutions to address women's issues in policies, laws, and development programs. In 2012 the

government introduced gender-responsive budgeting, and in 2016 revised the Financial Administration Proclamation 970/2016. The proclamation makes it mandatory to address gender issues during public budget preparation, which has underpinned the increase in public budget allocations to more than 60 percent on poverty-targeting actions. National initiatives like the Productive Safety Net Program also support gender equity.

Still, women's full potential is not being realized due to remaining barriers and differential access to productive resources like education and land. Women have limited access to gender-sensitive markets, credit, infrastructure, agricultural inputs, digital technology, and labor-saving devices that reduce drudgery in household work and food production. Gender parity has not been achieved at the secondary and tertiary school levels because girls have lower transition rates. About 60.0 percent of girls complete grade 8 and transition to secondary school compared with 64.4 percent among boys. In 2019 the gender parity index for grades 1-8 was 0.87 and for grades 9-12, 0.90—below the national target of 0.98.

Reforms are underway to enhance women's access to and control over productive resources and services for economic empowerment. The Ministry of Agriculture estimates that providing women farmers—who contribute 70 percent of food production—with equal access to productive resources could increase farm yields by 20-30 percent and raise agricultural output by 2.5-4.0 percent. The national land certification program has increased women's individual land ownership to 40 percent, and joint ownership to 25 percent. About 12 million women (2.1 million female heads of households) were issued land-holding certificates. Half of the 2.8 million farmers reached by agriculture extension services are women. In urban areas 30 percent of low-cost condominium houses are reserved for women and 70 percent are allotted equally between women and men.

To foster continued progress on gender issues, Ethiopia's development partners need to support the government in:

- Designing and integrating more gender-transformative strategies that address cultural, socioeconomic, traditional, and conventional practices with negative implications for women's access to productive resources.
- Reviewing policies and laws that limit equal participation in economic and social spheres.
- Enhancing the capacity of government staff and partners to conduct gender assessments of planned programs.
- Developing the capacity of extension workers to mains tream gender to analyze the needs of men and women, boys, and girls.
- Using communication channels accessible by women
- Ensuring that training is women-friendly.
- Designing gender-responsive, results-based management systems, with gender-sensitive indicators and tools for collecting and analyzing disaggregated data (FAO 2019).

Ethiopia harbors traditional practices and sociocultural gender norms that hurt women. These include female genital mutilation, early marriages, and gender-based violence. Nearly two-thirds of women age 15-49 are victims of female genital mutilation. Somali and afar regional states have the highest rates of the practice, with 99 percent of women age 15-49 having been circumcised. The prevalence of female genital mutilation has dropped from 74 percent in 2005—especially among women age 15-19—to 47 percent in 2016 (FDRE 2019a). Rural women are more likely to be circumcised than urban women (68 percent compared with 54 percent). Early marriage is also common in Ethiopia, reducing school attendance by girls. The median age at first marriage for women is 17.1 years, one of the lowest in Africa. About 27 percent of women age 30–34 were married by age 15—and more than 58 percent of girls age 15-19 have given birth, sometimes causing physical injury (World Bank 2019c).

Women are underrepresented in the labor market, especially in professional and managerial positions. In 2018 the labor force participation rate for women was 74.3 percent compared with 86.6 percent for men (AfDB 2019). Women's participation in skilled professions was just 32.6 percent, and at senior management levels only 26.0 percent. Women account for 20 percent of science and engineering professionals, 21 percent of business services agents, and 30 percent of information and communications technology workers (UNDP 2018). Women own only 16 percent of medium- and large-scale manufacturing firms and 22 percent of micro, small, and medium-size manufacturing firms (UNDP 2018).

In the 2019 Gender Inequality Index, Ethiopia scored 0.508 and ranked 123rd out of 162 countries. Unemployment among female youth is almost 30 percent compared with 19 percent among male youth (FDRE 2021). Men are paid almost 50 percent more on average than women, partly due to skills differentials—almost 60 percent of female workers are unskilled compared with 28.0 percent of men. More than a third of ever-married women have experienced gender-based violence—physical, emotional, or sexual violence from their husband or partner—with higher rate among women age 40-49 (38 percent), formerly married women (45 percent), and those in rural areas (36 percent compared with 11 percent in urban areas; AfDB 2020d).[5]

Women and children, especially those in poor rural households, face food and nutrition insecurity. Some 22 percent of women of reproductive age (15-49 years) are underweight because of inadequate energy intake, disease, or both (FAO 2019; WFP 2019). The highest share of underweight women occurs in Afar (39 percent), followed by Tigray (34 percent), Gambella (32 percent), and Somali (31 percent). Malnutrition due to low-nutrition diets, food insecurity, insufficient food intake, poor infant and young child feeding practices, and limited access to health services. Women, children, and the elderly are the most vulnerable to malnutrition. Poor nutrition among pregnant and lactating women increases their risk of childbirth complications.

3.4 Fragility and Spatial Risks

3.4.1 Social and Economic Fragility

Weak social cohesion—real or perceived—and a sense of marginalization and grievances lead to conflicts and violence, eroding a sense of belonging and stability. Ethiopia faces legacy challenges and grievances accumulated over decades. Fixing them requires concerted efforts. Government efforts are ongoing to strengthen the social fabric, advance a sense of belonging, develop respect for diversity, and encourage dialogue to resolve differences and foster peaceful coexistence. These efforts need to be scaled up and accelerated. Recovery and development efforts should follow the humanitarian-peace-development nexus to reinforce the social fabric through pro-poor, nondiscriminatory, and inclusive measures, within the lenses of "doing no harm" and "leaving no one behind." Increased trust in public administration and improved security and stability are needed to unleash Ethiopia's socioeconomic potential through inclusive bottom-up approaches. Social dialogue and social protection measures need to accompany public service delivery and private sector reforms for inclusive prosperity.

Since 2018 the government has taken steps to deepen democratic governance, open up political space, and engender national reconciliation. The election of Prime Minister Dr. Abiy Ahmed by the House of Peoples' Representatives in April 2018 and her reelection in October 2021 attest to the importance of economic and political reforms to build the foundation for sustainable peace and democracy. In an effort to deepen reconciliation, more than 20,000 political detainees were granted amnesty and exiled politicians were allowed to return home. The Ten-Year Development Plan emphasizes the need to build democratic and judicial institutions, as well as promote national consensus, a common vision, and government legitimacy.

To cement democracy and enhance transparency, the government has revised media, civil society, and electoral laws to advance participation. Poor performance on political stability is a result of internal tribal tensions and regional fragilities. The ongoing conflict will lead to economic instability and reduce foreign direct investment. For sustainable peace and social cohesion, leaders at the federal and regional levels should embrace dialogue and pursue reforms for an inclusive society. The African Union Commission and the United Nations have stressed the importance of resolving conflict through dialogue instead of protracted conflict with high human costs. Continued conflict will also undermine the stability needed to harness Ethiopia's potential—with wider implications for the Horn of Africa.

[4] Violence decreases with increasing household wealth and education level. Some 12.3 percent of women in the bottom quintile report having experienced sexual violence compared with 4.5 percent of those in the top quintile.

Key challenges include Ethiopia's ability to cope with a growing population and its implications for job creation, food security, and service provision. The economy is dominated by the informal sector, with 40-50 percent of the population self-employed in micro, small, and medium-size enterprises or unpaid family work. The private sector is susceptible to economic fluctuations, with large variations in income and vulnerability. Religious conflicts are relatively uncommon in Ethiopia because previous regimes maintained tight control over religious entities. But the opening of democratic space has sparked intercommunal conflicts and religious tensions, such as the arson attacks on Orthodox churches in the Oromia region in 2019. In some regions conflicts are motivated by ethnicity.

3.4.2 Political Fragility

Political fragility is becoming evident, reflecting unequal participation and access to social and economic opportunities. The 1995 Constitution enshrines a system of ethnic federalism that grants unlimited political autonomy to different ethnic groups, with all nationalities having the unconditional right to self-determination including the right to secession. But this setup is interpreted differently by political elites to either mean full autonomy to states—which could lead to Ethiopia's dissolution as a sovereign state if implemented—or the need for a reinforced authority at the federal level. The ongoing conflict in Tigray and other regions is partly driven by the ethnic-based federalism and need to preserve regional hegemony.

Investors are attracted by incentives such as land concessions offered to big companies to grow flowers and horticultural exports. But there is a feeling that federal and regional authorities expropriate land without providing much benefit to regions, mainly because the concessions create few jobs for local populations. Instead, professional positions are taken by people from other regions, partly due to skills gaps and disparities in education levels. Feelings of marginalization drive discontent and protests. Perceived regional inequalities and marginalization carry an elevated risk of conflict because of the ethnic angle they take and need to be carefully addressed for stability. Interethnic conflicts in the lowlands, mostly over pasture and water points, have displaced thousands of people, particularly along the Somali-Oromo border.

3.4.3 Youth Unemployment

Ethiopia's youthful population is both an advantage and a challenge for economic growth. Youth unemployment contributes to social instability regardless of a country's development stage. Ethiopia has a young population eager to participate in gainful, decent employment. Almost 70 percent of the country's people are under 30, with a median age of 19.5 years. Adequate planning for basic services and skills acquisition is needed for Ethiopia to benefit from the demographic dividend.

Urban youth unemployment is estimated at 25 percent—31 percent for women, 19 percent for men—and even the self-employed are mostly in the informal sector, with little job protection. Urban unemployment has been exacerbated by COVID-19 and conflicts, increasing fragility and providing ground for recruitment into terrorism and other harmful activities. The job crisis has exacerbated the vulnerability of young people. Every year some 150,000 young Ethiopians try to migrate to Asia, Europe, and Southern Africa in search of jobs, under hazardous conditions (ILO 2020b). Ethiopia needs to create at least 2.5 million jobs a year to ensure that labor force entrants are employed. The Ten-Year Development Plan aims to increase employment among graduates from 59 percent to 90 percent, increase the share of private sector jobs in technology and digitalization from 50 percent to 80 percent, and eliminate pay differentials between men and women for similar jobs, currently at 44 percent.

3.4.4 Cross-border and Subregional Fragility

Violent conflict is a major obstacle to development in the Horn of Africa, distorting subregional politics. Conflicts over access to common resources (pasture and water) are worsened by climate change and increasingly entwined with the spread of extremist ideology. Investments in conflict prevention, cross-border trade, and private sector development are needed to address the underlying causes in the region. Ethiopia shares borders with Eritrea to the north and northeast, Djibouti and Somalia to the east, South Sudan and Sudan to the west, and Kenya to the south. with Eritrea's independence, Ethiopia became landlocked. Ethiopia has historically faced many security and humanitarian challenges emanating from its location in the Horn of Africa. For example, Ethiopia hosts over 500,000 refugees from Eritrea, Somalia,

and South Sudan. The ongoing conflict in South Sudan and repeated clashes on the Sudan-Ethiopia border are undermining Ethiopia's stability and socioeconomic development.

The 2018 peace deal with Eritrea and the acceptance of the Border Commission ruling have eased the dispute between the two countries, after 20 years of strained relations and border closure following the 1989-91 war. Eritrea reestablished relations with Djibouti and Somalia, rejoined Inter-Governmental Authority on Development (IGAD), and ended its support to Ethiopian opposition groups operating from its territory. As a result, telecommunications, trade, transport services, and diplomatic relations between the two countries were restored. Dialogue continues on issues of regional infrastructure development, with an emphasis on trade and transport corridors linking the two countries.

Ethiopia is working with Djibouti, Kenya, and Sudan to address intercommunal conflicts among pastoral communities that straddle national borders. The Ethiopian-Sudan Joint Commission has strengthened cooperation on economic, social, and infrastructure development. Discussions are ongoing about security matters, illegal trade, and movement of citizens across borders with the Amhara, Benishangul-Gumuz, and Tigray regional states. But the contested agricultural land at Al Fashaga remains a challenge.

Historical grievances and real or perceived exclusion and marginalization have led to the recurrence of tensions and violence in several parts of Ethiopia, eroding efforts to strengthen social cohesion. Developments in October-November 2021 in the Tigray, Amhara, and Oromia regions have shown the need for development efforts to increase emphasis on whole-of-society approaches to reinforce social cohesion, dialogue for conflict prevention and peaceful resolution, application of do no harm and leave no one behind, and conflict sensitivity. Further discussion on recent developments and implications of fragility is provided in annex 3.

3.5 Private Sector Development

3.5.1 Private Sector Structure

Ethiopia's private sector is a mix of private and pseudo-public companies. The private sector includes companies linked to political elites, public enterprises acting as the private sector, and the conventional private sector comprising formal companies (domestic and foreign). Private companies run operations in agriculture, industry, construction, hotels and tourism, manufacturing, mining, oil and gas distribution, real estate development, transport (including air transport), trade and commerce, healthcare, and education and training.

Micro, small, and medium-size enterprises dominate the private sector, operating mainly in wholesale and retail trade. The private sector is driven by the informal sector, representing 50-60 percent of urban employment, and 42 percent of informal operators earn their livelihoods from microenterprises (Yeshineh 2015). Individual firms accounted for 42 percent of all firms in 2017, a decline from 50 percent in 1996. The number of private limited companies, cooperatives, and partnerships has increased over the past 25 years, but public ownership shrank from 26.0 percent in 1996 to 1.3 percent in 2017 due to privatization. The number of large firms has more than quadrupled, from 650,000 in 2010 to 2.7 million in 2020 (CSA and NBE 2021). Self-employment is the dominant business type, at 70 percent, followed by microenterprises at 29 percent.

The number of active licenses fell from 11,252 in 2017 to 9,880 in 2018, and in manufacturing from 2,800 to 2,441 (FDRE 2019a). This reflects the large informal sector—which thrives in part due to the weak business environment—and could explain low tax revenue collection. On the other hand, construction has the largest number of active licenses, signaling the sector's importance. During 1996-2017 the number of medium-size and large companies (defined as those with 10 or more employees) more than quintupled, from 642 to 3,596. Machinery, textiles, apparel, and basic iron and steel recorded annual increases of 30-100 percent over the same stretch (CSA and NBE 2021).

Entrepreneurial drive is low, constrained by the weak business environment with many regulatory procedures and limited facilitation. During 2016-18 Ethiopia registered less than 35,000 new companies a year. And new business density—defined as the number of newly registered private companies per 1,000 working-age people—averaged just 0.43, indicating low entrepreneurial activity (World Bank 2021b). That compares poorly with Kenya (1.4), Rwanda

(1.5), and Mauritius (9.7). The number of medium-size and large manufacturing enterprises grew 9.1 percent a year during 2012-18.

The state plays a key role in the private sector space through state enterprises that monopolize some sectors and generate unfair competition with domestic businesses. Despite the ongoing privatization strategy, some state enterprises are engaged in activities that can be more efficiently provided by, or at least in competition with, the private sector. These include the Ethiopian Shipping and Logistics Service Enterprise, Ethiopian Airlines, Shebele Transport Enterprise, Ethio-Telecom, Central Bank of Ethiopia, Development Bank of Ethiopia, Ethiopian Insurance Corporation, Ethiopia Sugar Corporation, and Metal and Engineering Corporation.

Foreign direct investment shot from $288 million in 2010 to a record $4 billion in 2017, making Ethiopia the second-largest recipient in Africa. In the wake of COVID-19 and recent political instability, such investment dropped to $2.4 billion in 2020 before recovering to $3.9 billion in 2021, pushed by the $850 million in proceeds from the new telecom license to the Global Partnership for Ethiopia. The main destination sectors for foreign direct investment included mineral extraction, real estate, manufacturing, and renewable energy.

3.5.2 Private Business Environment

Ongoing regulatory reforms aim to enhance private sector investment to spur economic growth and employment opportunities. While the urgency of the reforms is reflected by the fact that such initiatives are handled directly by the prime minister's office, coordination between various high-level committees and responsible ministries seems to be the missing link to ensuring consistency in regulatory quality and approaches. Ethiopia's competition law stifles private sector participation, competition, and innovation. In 2019 Ethiopia ranked 136th of 141 countries in domestic competition on the Global Competitiveness Index, and 119th on the extent of market dominance and 141st on competition in services (WEF 2020).

Competition in domestic markets is held back by political interests in banking, insurance, telecommunications, and electricity, which are considered strategic sectors and have not been fully opened to competition. And legal and institutional gaps—including weak laws, duplicated regulations, unchecked discretion, and poor information and communications technology support—undermine the enforcement of competition. The Trade Competition and Consumers Protection Authority, in charge of competition policy, lacks the capacity and power to investigate violations and bring charges against culprits.

Despite progress on infrastructure development, quality and connectivity need to be improved. Though the government has invested heavily in infrastructure, resource gaps impede the completion of envisaged projects and expanded connections. A key challenge is engaging the private sector in these efforts and reducing dependence on government funding. Quality transportation services, communications, and energy infrastructure are vital for economic growth and economic competitiveness as well as for the quality of life. In the 2019 Global Competitiveness Index, Ethiopia ranked 123rd of 141 countries on infrastructure development, reflecting weak road connectivity, low-quality road infrastructure, inefficient air transport and seaport services, and poor electricity access (WEF 2019).

3.5.3 Private Sector Contribution to the Economy

Comprehensive official data are not available on the size of the private sector and its contribution to GDP or employment. The share of private sector employment is estimated at 95.8 percent, of which 89.9 percent is by the informal sector and 5.9 percent by formal companies. In 2018, 12 percent of workers were estimated to be employed in the formal sector, with the public sector (general government and state enterprises) accounting for half (World Bank 2019b).

3.5.4 Opportunities to Enhance Private Sector Participation

Ethiopia needs to leverage ongoing macroeconomic and structural reforms for private sector development. An attractive business environment is needed to hasten private sector growth and increase foreign direct investment. The private sector's role as an engine of economic growth is recognized in several strategies and the 1995 Constitution,

which provides for protection and ownership of private property. The government is implementing reforms to expand the role of the private sector in Ethiopia's development, emphasizing foreign direct investment for rapid economic transformation. Ethiopia's population of more than 115 million people and growing infrastructure offer considerable market potential. Stronger coordination between the public and private sectors would enhance competition and investment outcomes. Initiatives such as public-private partnerships and integrated agro-industrial parks are already attracting investments and creating jobs in certain sectors. The private sector is better equipped to respond to changing demands, particularly by increasing quality, changing specifications, and ensuring timely delivery.

Simpler regulation is needed to streamline processes, reduce compliance costs, and increase transparency. Private sector participation in shaping the regulatory framework needs to be formalized to address concerns and expand opportunities for private startups and economic growth. A survey of 200 private sector representatives found that 50 percent considered the transparency of Ethiopia's laws and policy implementation to be poor (only 15 percent rated it as good). Ethiopia's complicated legal framework for businesses is summarized in box 3.1.

Ethiopia has an active investment policy and instruments like industrial parks and integrated agro-industrial parks to ease the constraints facing investors. Well-developed working premises, infrastructure and energy, trade and customs facilitation, and trade logistics are expected to attract high-quality investment in key manufacturing sectors that can support export growth and integration with the global economy (World Bank 2019a). Efficient adjudication of investment-related issues is needed to boost private sector participation. In addition, attracting investors will require promulgating a comprehensive arbitration law and ratifying the New York Convention on Arbitration.

Box 3.1: Ethiopia's legal framework for private sector growth

Ethiopia's regulatory environment is complex and perceived as hazy and discretionary. Regulations are badly designed or their implementation is cumbersome, with duplications. diverse requirements, excessive discretion, and poor information and communications technology support. The government actively intervenes in the economy through rules constraining the private sector and through state enterprises active in key economic sectors. Several sectors are excluded from private participation and some reserved for national investors, despite the reforms in Investment Proclamation 1180/2020 and Investment Regulation 474/2020.

In addition, major gaps remain in the rule of law and regulatory environment. In 2019 Ethiopia ranked 118th of 126 countries on the Rule of Law Index and 120th on the Regulatory Enforcement Indicator (extent to which regulations are fairly and effectively enforced; WEF 2020). On Civil Justice (extent to which people can resolve grievances peacefully and effectively through the civil justice system) and Criminal Justice (conventional mechanism to redress grievances and bring action to individuals for offenses against society), Ethiopia ranks 111th and 104th. On the World Economic Forum's 2019 Global Competitiveness Index, Ethiopia ranked 90th of 141 countries on judicial independence—a key element of ensuring the rule of law.

The Ease of Doing Business Initiative, led by the prime minister's office, is an opportunity to attract private investment. The ongoing macroeconomic and structural reforms and creation of industrial parks and integrated agro-industrial parks aim to ease constraints facing investors and attract high-quality investment into manufacturing to support export growth and integration with the global economy (World Bank 2019b).

3.6 Sustainable Urban Development

Ethiopia's urban population is about 22 percent of the country's total and growing by 4.6 percent a year. The capital, Addis Ababa, is home to 25 percent of Ethiopia's urban population and is one of Africa's fastest-growing cities. Growing by 14 percent a year over the past decade and contributing about half of GDP, the city plays a strategic role as the engine of national growth. Despite their strong contribution to national economic growth, urban centers face many challenges. For example, in Addis Ababa unemployment is estimated at 24 percent and poverty at 22 percent. To ensure sustainable growth of urban centers, better jobs, and increased investment and urban tourism, steps should be taken to strengthen the capacity of urban planning and governance to improve land use management and provide essential services such as healthcare, education, water and sanitation, transportation, affordable housing, waste management, and social safety nets. A roadmap for organized urban growth is needed to support economic prosperity, create jobs, and deliver health and environmental benefits by promoting livable urban centers and realizing Addis Ababa's aspiration of being Africa's diplomatic capital.

3.7 Civil Society Engagement

Civil society organizations in Ethiopia can be traced to the 1960s, when the civil code governing voluntary organizations was issued. But civil society organizations really started operations during 1975-91, when they were allowed to act and serve—mainly in relief operations. In 2018 Ethiopia revised its approach to regulating such organizations, with new laws enacted to allow give them more freedom. Charities and Societies Proclamation 621/2009, which prohibited civil society organizations from engaging in advocacy, governance, and human rights issues, was replaced by Civil Society Organizations Agency Proclamation 1113/2019. The new law applies to foreign organizations, those in Addis Abba and Dire Dawa, and local organizations operating in more than one region. Restrictions on funding for civil society organizations were lifted and allowed for the re-entry and operations of international organizations in Ethiopia.[6] Civil society organizations have become fairly active in democracy and governance activities. The Agency for Civil Society Organizations was established to oversee the registration (away from the Ministry of Internal Affairs) and operations of such organizations in Ethiopia.

Over the past 50 years Ethiopia has had about 3,822 civil society organizations. Yet they face challenges of political rivalry—mostly among ethnic lines, because political parties tend to represent specific ethnic groups—and limited capacity to develop advocacy tools and learning about best practices. The opening of civic space provides opportunities to engage with Ethiopian civil society organizations. To achieve inclusive, sustainable development, the African Development Bank could support the capacity building of such organizations within the proposed priority areas and new interventions. With stronger capacities, civil society organizations could become reliable allies in designing, implementing, and monitoring Bank projects in Ethiopia.

[6] https://www.civicus.org/index.php/media-resources/news/interviews/4312-ethiopia-for-civil-society-2019-has-been-a-new-beginning.

CHAPTER: 4

DEVELOPMENT GAPS BASED ON THE HIGH 5S

This chapter diagnoses Ethiopia's development gaps and challenges based on the African Development Bank's High 5 priorities: Light Up and Power Africa, Feed Africa, Industrialize Africa, Integrate Africa, and Improve the Quality of Life for the People of Africa. It uses the Bank's reform priorities to analyze Ethiopia's development gaps and assesses what can be done to resolve them in the medium to long term. To inform future engagements between the Bank and the government, the diagnosis focuses on opportunities in agriculture, industry (including manufacturing and agroprocessing), energy, and the private sector's role in the economy.

4.1 Agriculture

4.1.1 Overall Development Profile of Agriculture

The Ministry of Agriculture is responsible for transforming the sector through crop extension services, livestock resource development, natural resources management, food security, and agricultural marketing. The ministry collaborates with other ministries and government agencies such as the Agriculture Transformation Agency to address critical sector challenges. The Federal Cooperative Agency and Rural Land Use and Land Administration Directorate are also under the ministry's overall guidance. The Ministry of Water and Energy is responsible for the building and managing medium-size and large irrigation systems. The Bureau of Agriculture is the main executing organ at the regional level. The Ethiopian Institute of Agricultural Research and regional agricultural research centers are mandated to promote agricultural technology. The Rural Economic Development and Food Security Sector Working Group is the umbrella platform for donor coordination, harmonization, and policy dialogue. The working group comprises four technical committees covering agriculture growth, natural resource management, disaster risk management, and food security and livestock.

Agriculture remains a prominent sector, contributing 32 percent of Ethiopia's GDP, employing almost 70 percent of the population, and accounting for 79 percent of exports. The Ten-Year Development Plan for 2021-30 identifies unused arable land and other natural resource endowments as critical to its success. Ethiopia has comparative advantages in several crops such as coffee, oil seeds, pulses, cotton, horticultural crops (fruits and vegetables), and livestock products. During 2020 agricultural exports (coffee, oil seeds, vegetables, and flowers) earned $1.6 billion, accounting for 65 percent of merchandise exports, up from 63 percent in 2019. The increase in these exports reflect resilience to COVID-19 shocks. Coffee earnings increased marginally from 31 percent in 2019 to 32 percent in 2020 and oil seeds from 13 to 15 percent.

Although only 32 percent of Ethiopia's land is arable, agriculture offers large potential to accelerate inclusive growth if value chains are developed. But small landholdings, traditional farming methods, limited use of modern inputs and

mechanization, and weak extension services constrain productivity. About 95 percent of agricultural production is undertaken by smallholder farmers, with less than one hectare of land on average, resulting in low crop and livestock yields. The government is trying to improve yields of selected crops in highly productive areas. This includes deploying resources to apply agricultural technology such as heat-tolerant wheat varieties developed in cooperation with Technologies for African Agricultural Transformation, extension services, integrated agro-industrial parks, and staple commodities processing zones. These measures are yielding results: for example, coffee output jumped from 3,900 metric tons in 2017 to 4,925 in 2020, and wheat 416 metric tons in 2017 to 443 in 2020 (International Trade Administration 2021).

During 2010-15 agricultural GDP grew 6.6 percent a year but in 2016-20 declined to 4.2 percent mainly due to droughts and conflicts, especially in agricultural regions. Some 10.8 million hectares of land were cultivated in 2020 for major cereal crops (teff, maize, wheat, sorghum, barley, millet) and 27.8 million metric tons of food produced (FDRE 2021). Wheat accounts for 18 percent of cereal production and has become an important crop for food security and supply to agro-industries. The increase in wheat production is due to improved farming practices including irrigation and other support provided to farmers. Rapid population growth rate and urbanization have increased demand for wheat. The government has developed an ambitious plan for wheat self-sufficiency by 2023, underpinned by favorable agro-ecologies, supportive wheat production policy, and expansion of irrigation to meet domestic demand and reduce wheat imports.

4.1.2 Spatial Distribution and Potential Value Chains

Over the past decade, agricultural productivity in areas with high cereal potential has improved thanks to the use of modern farm inputs such as improved seeds and fertilizers and mechanization services. Service centers managed by cooperative unions and the private sector have increased. The mechanization strategy, with about 400 mechanization service providers supporting small farmers, aims to increase smallholder productivity. This will contribute to both higher incomes and rural economic development. But the use of machinery is limited to primary cultivation and grain harvesting. Postharvest losses still account for 15-35 percent of output and require equal emphasis.

Ethiopia has considerable irrigation potential, which is key to transforming agriculture and the economy. Irrigation is an instrument for reliable, sustainable agricultural production to ensure food security and supply to agroprocessing industries. Estimates suggest that Ethiopia has about 5 million hectares of irrigable land but only 10-12 percent is developed. Irrigation is practiced by smallholders (less than 200 hectares), medium-size (200-3,000 hectares), and large farmers (more than 3,000 hectares). Irrigation and water use systems in small-scale irrigation are managed by communities through water users' associations (or irrigation cooperatives), while the medium-size and large irrigation schemes are managed by public enterprises. The main challenge involves limited skills in designing, building, operating, and maintaining schemes at scale. Investments to strengthen these skills would help Ethiopia exploit its large agricultural potential, create jobs, and increase exports.

Agro-industries, mainly for food and beverages, account for 5 percent of GDP and contribute to manufacturing value addition. Developing agro-industry is key to transforming Ethiopia's agriculture sector. This calls for a transition from trade in raw products to value addition through processing and quality standards for global markets. Incentives to adopt high-quality inputs and best agronomic practices are important for increased farm earnings and creation of decent jobs for women and young people. But gaps remain in terms of infrastructure, agribusiness services, and capacity to supply raw materials to agroprocessors.

Gaps in transport and energy infrastructure constrain agricultural development. Increased connectivity with roads (highways, feeder roads, bridges) and railways are critical to expanding access to markets for agricultural produce and inputs for farmers. Under the Second Growth and Transformation Plan (2016-20), 126,773 kilometers of all-weather roads were built out of a planned 220,000. At the regional level, the Ethiopia-Djibouti and Ethiopia-Kenya transport corridors are nearly complete and will improve road transport for Ethiopia´s exports and imports. The railway network represents a small share of the national transport system, with three railway lines totaling 1,400 kilometers. Ethiopia

requires a structured plan to link agricultural areas to ease market access. Despite the expansion of road infrastructure, Ethiopia's score on road connectivity from the 2019 Global Competitiveness Index was just 32 (of 100), putting it 123rd of 141 countries. The quality of roads score was 3.3 (of 7), giving it a ranking of 103rd. Power transmission and distribution losses scored 17.3 (of 100) landing Ethiopia at 107th (WEF 2019). Access to reliable, affordable energy sources is needed to support agroprocessing and development of cold chains.

4.1.3 Market Efficiency

Poor market access is a major constraint to agricultural productivity, particularly for farmers in remote and hard-to-reach areas. Agricultural marketing systems and infrastructure in rural Ethiopia are dominated by traditional, informal exchanges, with weak logistics including storage, loading and unloading facilities, quality checks, and financial services. This conflates other issues such as high trading costs, low product quality and value addition, and high postharvest losses. Landholdings average just 0.85 hectare per farmer, limiting commercialization and use of modern methods. In addition, limited access to and use of modern inputs, weak coordination, and use of traditional technology limit agricultural productivity and transformation. Agricultural productivity is also restrained by climate-induced recurrent droughts and limited irrigation, poor infrastructure and market links, limited access to finance, low livestock productivity due to poor selection and management of breeds, and inadequate feed and animal health service facilities. Limited private sector involvement and weak public sector capacity further constrain agricultural growth and innovation.

4.1.4 Reforms

Several policies and strategies have been developed to support agricultural development priorities. Recent national plans for agriculture include the Sustainable Development and Poverty Reduction Program, 2002-04; Plan for Accelerated and Sustained Development to End Poverty, 2005-09; and the First and Second Growth and Transformation Plan, 2010-15 and 2016-20. The First Growth and Transformation Plan focused on boosting growth in agricultural productivity to ensure food security and supporting the food industry by increasing crop production, enhancing crop productivity by applying good agricultural practices, and improving extension services. The Second Growth and Transformation Plan builds on the achievements and lessons from implementation of the first plan. Though accelerated growth in agricultural productivity continues to be an important area of focus—because food security remains a persistent challenge—a shift is envisaged toward high-value crops by developing links with agro-industries, reinforced by a market system that benefits farmers.

The Ten-Year Development Plan, 2021-30, includes several reforms for agricultural transformation including land use policy and planning; improved crop and livestock technology, inputs, and services; a legal framework for agriculture focused on financial services; market links and commercial value chains; expanding irrigation infrastructure and improving water use; and expanding private sector participation. To address the small landholdings, the Agricultural Transformation Agency and Ministry of Agriculture have launched a program to transform smallholder farms into commercial ones through prioritized distribution of improved inputs and commodities. So far, more than 1.3 million farmers have been organized in 30,000 clusters across Ethiopia.

Transforming agriculture requires strong coordination and collaboration with several stakeholders. Ongoing programs with potential to accelerate value addition and industrialization include the Agricultural Transformation Program in 167 high-potential districts, Sustainable Land Management, Productive Safety Net Program in drought-prone areas, and Drought Resilience in pastoral lowlands. The Bank is supporting the Agricultural Transformation Program through Drought Resilience and Sustainable Livelihood Projects in four pastoral lowland regions, the Integrated Agro-Industrial Parks Support Project, and the Productivity Enhancement Support to Integrated Agro-Industrial Parks and Youth Employment. The Bank will continue to support the program to promote market-led agricultural growth and rural transformation through innovative financing instruments and policy dialogue. The Bank should strengthen policy dialogue in areas such as land consolidation and mechanization, irrigation and market infrastructure, private sector engagement, promoting rural youth employment, and enhancing resilience to climate change and other shocks. The Bank should focus on land consolidation to encourage commercialization and improve irrigation development, rural roads,

and market infrastructure to enhance the environment for private sector participation.

4.2 Industry

Ethiopia's industrialization strategy aims to promote manufacturing through state investments, foreign direct investment, and domestic private investment. Manufacturing is the priority area for foreign direct investment—particularly textiles and apparel, leather products, agroprocessing, pharmaceuticals, and chemical production. The goal is to maximize Ethiopia's comparative advantage by building on the strong agricultural foundation in the transition to new tradable activities in manufacturing that employ large numbers of semiskilled workers. In 2020 half of foreign direct investment in Ethiopia went to manufacturing.

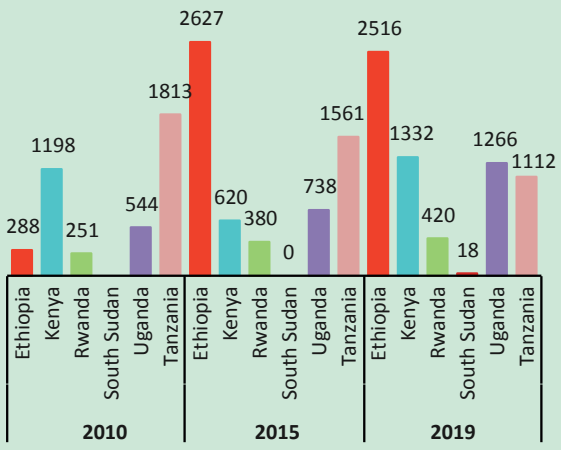
4.2.1 Status of Industrial Development

State-led construction fueled the tripling of industry's contribution to GDP—from 10 percent in 2000 to 29 percent in 2020. Yet manufacturing has remained modest at 6.9 percent of GDP. Value addition in manufacturing is dominated by medium-size and large firms, which contribute about 72 percent. Despite robust growth in the past two decades, manufacturing remains weak and has not spurred structural transformation. Growth of manufactured exports and employment in the sector remain low. Manufactured exports tend to be low-value products (leather and leather products, textiles, apparel). The slow increase in manufactured exports suggests limited structural transformation.

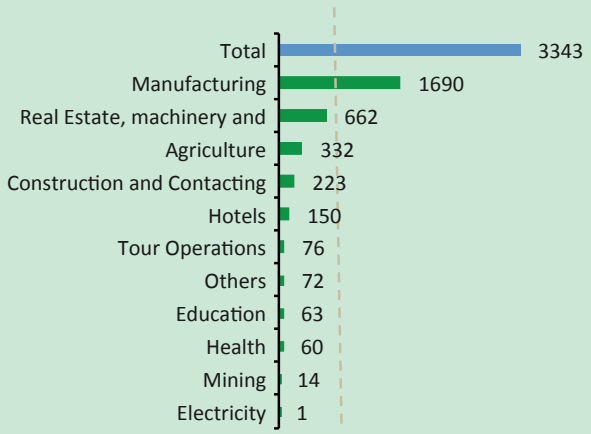
Ethiopia is still at an early stage of industrialization relative to its regional peers. Despite receiving more foreign direct investment than other East African countries in recent years (figure 4.1a)—much of which went to manufacturing and real estate (figure 4.1b)—Ethiopia underperforms similar landlocked countries such as Rwanda and Uganda on manufacturing and other industrializing lower-middle-income countries such as Bangladesh and Vietnam. Still, Ethiopia is well positioned to expand industrialization.

Figure 4.1: Foreign direct investment in Ethiopia and regional peers and its areas of focus

a. Foreign direct investment in selected East African countries, 2010, 2015, and 2019 (millions of US$)



b. Foreign direct investment projects by subsector, 1992-2021 (number of projects)



Source: UNCTAD 2020.
Note: Dotted lines in both figures indicate the average.

Manufacturing employs about 4.5 percent of Ethiopia's workforce, with annual growth of 4.8 percent during 2015-20. Stimulated by the expansion of public infrastructure and favorable policies, construction value added rose from 11.1 percent of GDP in 2011 to 27.7 percent in 2015, then fell to 22.9 percent in 2017 and 20.5 percent in 2019 (UNStat 2021). The number of jobs more than tripled, from 229,000 to 825,000, more than doubling construction's share of total employment from 0.9 percent to 1.9 percent. Manufacturing industries related to construction (cement and other building materials) grew rapidly over this period in line with growth in demand.

For a variety of reasons, Ethiopia's vast mineral resources—which have the potential to generate much-needed foreign exchange—remain untapped. Mining contributes only 0.5 percent of GDP. The Ten-Year Development Plan, 2021-30 identifies various natural resource endowments with the potential for promoting industrial growth. These include commercial quantities of gemstones, ornamental stones, energy (oil and gas), metals, and metallic minerals (gold, coal, iron ore, copper, potash, platinum, tantalum, marble). But their potential is not being exploited. Significant quantities of oil and natural gas exist in the Ogaden region and are under exploration. Key constraints to mining growth include institutional and technical barriers for large miners, the absence of a legal framework to manage miners' relationships with local communities, and informality and pricing issues related to gold mining. Incentives to investors in the mining sector include a 25 percent corporate tax rate and provisions for 10 years' loss carryforward and royalty charges at 4 percent for industrial minerals, 5 percent for metallic minerals, and 7 percent for gold. The government aims to increase the contribution of minerals to at least 10 percent of GDP by 2030. In 2020 gold exports grew 12 percent.

4.2.2 Enablers and Constraints to Industrial Development Infrastructure quantity and quality

Quality infrastructure is crucial for Ethiopia to achieve its ambition of becoming a middle-income country by 2025 and achieving structural transformation. Since 1997 the government has increasingly invested in quality infrastructure, spending about half its annual budget to develop roads, aviation, sea and railway transport, and energy generation and transmission facilities. But Ethiopia's competitiveness remains low due to high costs and low-quality transport services. Sustained investments in transport are a top priority of the Ten-Year Development Plan (2021-30) because of their role in promoting growth. Integrated, multimodal transport networks with inter-connected systems of corridors (road, rail) and nodes (ports, airports) are needed to foster faster, inclusive growth. In 2020 imports spent an average of 40 days at border crossings. Ports have low capacity for freight handling and administration, with the average waiting time also estimated at 40 days. There are seven dry ports, mostly along the Addis-Djibouti transport corridor. Private sector participation is encouraged through public-private partnerships. A better rail network would provide manufacturing firms with reliable, lower-cost routes to external markets.

Adequate, reliable transport infrastructure is a key enabler of industrial development. Ethiopia's roads carry 95 percent of freight and passenger traffic. Over the past 10 years, freight and passenger transport demand has increased by 10.4 percent a year. At least 43 percent of the population lives with 2 kilometers of all-weather road. Ethiopia relies on the port of Djibouti for its exports and imports, with the bulk of freight transported by road. In 2020 the road network was about 144,000 kilometers, with road density of about 130 kilometers per 1,000 square kilometers. About 70,000 kilometers of gravel rural access roads have been built, improving accessibility. The federal government manages about 30 percent of the road network (trunk roads connecting regions and major cities), regional governments 38 percent, and districts and communities 32 percent. The length of the road network length has more than tripled in the past 16 years, with about 74 percent of roads in good condition. But growing demand has increased pressure on roads, and the rural road network is mostly unpaved and has limited traffic during wet seasons. The road network is based on a radial structure, with Addis Ababa at the center. But is does not reach large parts of the hinterlands. An integrated, multimodal transport network consisting of an interconnected system of corridors (road, rail) and nodes (ports, airports) is needed.

Railway transport is sparse and generally dated. The three railway lines total about 1,400 kilometers. The Djibouti-Dire Dawa railway line was completed in 1902 and the Dire Dawa-Addis Ababa line in 1917. The 750-kilometer standard

gauge line between Addis Ababa and the port of Djibouti was completed in 2018, cutting transit time to 10 hours—an 840 percent reduction. In 2015 a 34-kilometer light rail system was completed in Addis Ababa to ease city commutes. About 35 percent of Ethiopia's and 70 percent of Djibouti's populations live along the railway corridor, making it an essential transport route. The Ethiopian Railway Corporation has identified eight railway corridors for study, design, and eventual implementation, with a total estimated length of 5,060 kilometers. The 392-kilometer Awash-Kombolcha-Hara Gebaya Railway is under construction. These costly investments in railway development make it necessary to conduct detailed feasibility studies and economic analyses to ensure appropriate designs with strong returns on investment. The Bank is funding the feasibility study for a proposed Sudan-Ethiopia railway connection.

The Ethiopian Civil Aviation Authority regulates air transport, and Ethiopian Airlines is responsible for constructing, maintaining, and managing airports and aerodromes. Ethiopian Airlines, the national carrier and Africa's largest airline, flies to more than 100 international and 20 domestic destinations. Of the country's 18 airports, 5 meet international standards (Addis Ababa, Bahir Dar, Dire Dawa, Hawassa, Mekele). Addis Ababa Bole Airport is one of the busiest airports in East Africa, with annual capacity of 22 million passengers and 600,000 metric tons of cargo. Fifteen international carriers operate from the airport, along with six national operators serving domestic routes.

The Federal Maritime Affairs Authority—part of the Ministry of Transport—regulates maritime transport. Some 86 percent of Ethiopia's external trade is routed through the port of Djibouti along the Addis Ababa-Galafi-Djibouti road corridor. The next most important corridor is Dire Dawa-Jijiga, which handles 4.4 percent of trade through Togo's Wechale border post with Somalia. There are also two corridors connecting to Sudan through the border posts of Humera and Metema and one connection to Kenya through the Moyale border. Logistics chains between production and consumption centers are weak, as are the main transportation nodes for trade. Only a few dry ports managed by the public sector serve exports and imports of goods. As a result, Ethiopia fares poorly in terms of the number of days to import (60 days) and export (10 days), compared with the Sub-Saharan average of 9.3 and 6.7 days. Logistics are spread across many intermediaries and brokers involved in the distribution and commercialization of agricultural products. Reforms to allow the private sector to operate dry ports are being debated. All the operators in rail, maritime, air, and logistics are state enterprises.

Access to reliable, affordable energy is critical for sustained industrial growth. Despite its large potential, Ethiopia has the second-largest energy access deficit in Sub-Saharan Africa (after Nigeria) and the third largest in the world. While significant public investments have increased generation capacity, supply does not meet demand. Key challenges include transmission and distribution gaps and the hydro-dominated energy mix, which is affected by droughts. Ethiopia's installed energy capacity is about 4,000 megawatts with 92 percent of it from hydro, 7.8 percent from wind, and 0.2 percent from geothermal. Ethiopia's reliance on hydropower makes it vulnerable to droughts and other effects of climate change. Energy supply gaps limit investments in pressurized irrigation technology that would improve farm yields and cold storage facilities. New firms seeking electricity connections can wait up to two years, and frequent power outages result in losses for industries and households. Backup generators increase costs and limit competitiveness, especially for smaller firms. The government aims to attain energy generation of 10 gigawatts by 2022 and 100 percent electrification by 2025 and become a regional power hub.

Regulations and Institutions for Industrial Development

Institutions engaged in industrial development are being strengthened through policy and strategy reforms and the establishment of specialized institutions. Key institutions include the Development Bank of Ethiopia, Ethiopian Investment Commission, Ethiopian Investment Board, Ethiopian Privatization Agency, and regional investment bureaus. These institutions' roles in investment undertakings range from licensing to production and service provision. Chaired by the Prime Minister, the Ethiopian Investment Board is responsible for legislative and policy decisions related to areas of investment and the incentives provided to investors. The board is also responsible for deciding appeals against decisions of the Ethiopian Investment Commission, which makes service delivery more efficient. The commission is responsible for promoting foreign direct investment.

The transport sector has several regulatory agencies under the Ministry of Transport that are responsible for policy, planning, and infrastructure and network development. The Ethiopian Roads Authority is responsible for building and maintaining the federal network. The Ethiopian Road Fund is in charge of road maintenance and resource mobilization. And the Federal Transport Authority is in charge of regulating land transport services. Other agencies include regional road authorities responsible for expanding and maintaining the road networks in their regions; the Ethiopian Shipping and Logistics Services Enterprise, which serves both international multimodal transport and inland ports; the Maritime and Transit Service Enterprise, which acts as a freight forwarder in Djibouti; the Ethiopian Railway Corporation, in charge of planning and building new railway infrastructure and operations of passenger and cargo transport services; and the Ethiopian Civil Aviation Authority, responsible for air traffic management.

Ethiopia's 2009 Information and Communications Technology Policy recognizes the sector as an integral part of the country's growth and transformation. Ethiopia ranks 170th of 176 countries on the 2017 ICT Development Index due to poor telecommunications penetration and limited skills and innovation. In 2020 only 45 percent of the population had a mobile phone connection, compared with 51 percent in Kenya. This, despite annual subscriber growth of more than 80 percent and $3.1 billion invested in infrastructure and service expansion over the past decade. Ethio Telecom, the only telecom provider, faces efficiency challenges. Reforms of the sector are ongoing, with a new license awarded to the Global Partnership for Ethiopia in June 2021. Bidding for another license—and for 40 percent of Ethio Telcom—is ongoing to expand private participation and increase competition, efficiency, and innovation. Internet penetration remains low, constraining trade and potentially holding Ethiopia back from the benefits of the African Continental Free Trade Area (AfCFTA) agreement. Only about 24 percent of the population used the internet in 2020, up from 8 percent in 2014 (ITU 2021).

4.2.3 Constraints to Manufacturing Growth

A weak private sector constrains growth in Ethiopia's manufacturing sector. Average industrial capacity utilization is below 70 percent—and even lower for the chemical, leather, and metal industries, where it ranges from 49-55 percent. The World Economic Forum's 2019 Global Competitiveness Index identified Ethiopia's top five obstacles to doing business as inefficient government bureaucracy, foreign currency regulations, access to finance, corruption, and inadequate infrastructure. During public-private dialogues, firms identified access to finance, burdensome tax administration, limited access to land, electricity availability and reliability, and unfair competition as the top five constraints to investing in Ethiopia (World Bank 2015).

Filling skills gaps and improving trade logistics are key to increasing competitiveness. Business entry regulations should be eased to encourage new firms. As reforms proceed, the focus should be on the most effective measures in the short to medium term and on the sectors and subsectors that show the most promise for comparative advantage and job creation. It will also be important to assess implementation capacity and implications for governance and the political economy of policy reforms.

Weak backward and forward links in industry result in high costs. Emerging manufacturing industries like leather and textiles rely on agriculture, with limited links to other sectors. For example, 65-70 percent of accessories for leather and leather products are imported. Limited and dispersed sources of production make it difficult for firms to secure quality raw materials in a timely manner. Agroprocessing and leather industries struggle to secure the volume of agricultural commodities they need as inputs. Limited access to finance and foreign currency for imported intermediate inputs limits capacity to source inputs and leverage the benefits of global value chains. This problem is compounded by labor inefficiencies and results in high costs, diminishing the value proposition for investors. Firms involved in processing edible oil and coffee fail to certify their products despite growing international demand and price premiums. High-quality, specialized logistics services for specific goods are limited, increasing operational challenges for firms.

Low skills and technical capacity hinder industrial growth. Much of Ethiopia's workforce is unreliable, with unpredictable attendance, a low work ethic, high turnover, and civil unrest undermining industrial performance. Firms identify deficiencies

in workers' technical and soft skills as major challenges. In agroprocessing, firms face skills gaps in specialist grading, machine operation, and plant management and supervision. In garments, agroprocessing, metals, and engineering, the failure of local manufacturers to adopt best practices in technology has led to low-quality products and thus an inability to command premium prices. In textiles and garments, many firms have dated spinning equipment that cannot produce globally competitive standard yarns.

4.2.4 The Private Sector's Role in Accelerating Industrial Development

Increased private sector participation in the economy is critical to sustaining Ethiopia's high growth as well as create jobs, reduce poverty, improve service delivery, and enhance food security. As noted, state enterprises dominate key sectors of the economy such as telecommunications, finance, energy, logistics, transport, and manufacturing. Further, public sector investments still account for a large share of total investment, creating big opportunities for private sector growth to leverage Ethiopia's comparative advantages.

Expanding domestic and external markets is key for private sector growth, job creation, and economic transformation. Over the past decade the government has invested heavily in industrial parks and infrastructure to attract private sector investment. Further mapping of private sector constraints is required to identify those that affect competitiveness.

Extent of private-public partnerships

Public-private partnerships have emerged to meet Ethiopia's large infrastructure financing requirements by tapping into the private sector to finance and improve project management. The government recognizes the scale of required investments and the need to involve the private sector to raise the funds needed to sustain economic growth and expand sustainable infrastructure. Public-private partnerships have been identified as a model for infrastructure service delivery and a valuable resource for the government to leverage. Such partnerships are ongoing in energy generation, and feasibility studies have been completed for them in hydro and solar power. But private participation in energy transmission and distribution remains restricted.

Laws and regulations for public-private partnerships

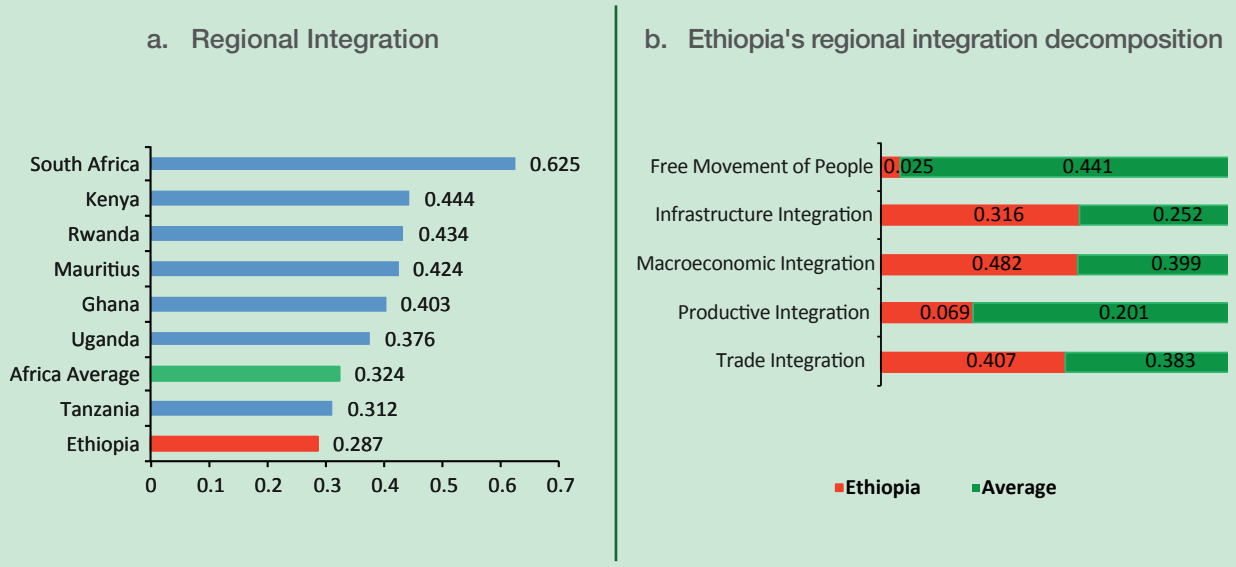
Legislation on public-private partnerships was approved in January 2018, with Bank support, to catalyze private investment and finance. The law recognizes the importance of the private sector in supporting economic growth and improving the quality of public services. A Public-Private Partnership Board was formed to grant approvals at key milestones in project development, from tendering to contract awarding. Also supported by the Bank, a directorate in the Ministry of Finance serves as secretariat to the board, promotes such partnerships, establishes policy guidelines, conceptualizes projects in consultation with line ministries, and ensures compliance with guidelines. As of June 2021, 24 private-public partnership projects worth $9 billion had been approved for solar power generation and infrastructure development.

4.3 Integration and Trade

4.3.1 Institutions for Regional Integration and Trade

Ethiopia's performance on regional integration has been poor. In 2019 it ranked 40th of 54 African countries on the Bank's Regional Integration Index Report, with a score of 0.287—below the continental average of 0.324 and regional peers such as Kenya, Mauritius, and Rwanda (figure 4.2a). Ethiopia's performance on regional integration is underscored by low scores on the free movement of people (0.025) and productive integration (0.07; figure 4.2b). In 2017 Ethiopia introduced e-visas, enabling nationals of 92 countries to obtain three-month tourist visas on arrival at Addis Ababa Airport. But that policy was suspended in June 2021 due to the ongoing conflict. Free movement of people plays an important role in increasing investment, improving local value chains, and transferring knowledge between countries.

Figure 4.2: Indicators of regional integration in Ethiopia, 2019



Source: AfDB 2020g.

Although Ethiopia has ratified several protocols of key regional economic integration agreements, much effort is required to reap their benefits. Ethiopia is a member of the Common Market for Eastern and Southern Africa (COMESA), COMESA Free Trade Agreement, Inter-Governmental Authority on Development (IGAD), and African Continental Free Trade Area (AfCFTA), and has signed a memorandum of understanding and transport corridor service agreement with Kenya and South Sudan to ease the movement of people and goods. Discussions are underway with Eritrea, Djibouti, South Sudan, Sudan, and Yemen to strengthen economic cooperation with the aim of improving infrastructure, services, and connectivity to mutually enhance competitiveness. Ethiopia is a key member of the Horn of Africa Initiative, along withDjibouti, Eritrea, Kenya, and Somalia).[7] Ethiopia plans to increase petroleum imports from South Sudan, and many Ethiopian businesses are investing there in anticipation of rapid economic growth. Increased regional integration under the AfCFTA agreement will help Ethiopia improve its untapped export potential in countries such as Djibouti, Kenya, Somalia, South Africa, and Sudan (ITC 2021). The agreement is expected to benefit Ethiopia by accelerating industrialization (box 4.1). With increasing investment in energy production, Ethiopia plans to sell hydropower to Kenya, South Sudan, and Sudan to enhance its revenue base.

Ethiopia started negotiations to join the World Trade Organization (WTO) in January 2020. The fourth meeting of the WTO Working Party expressed support for Ethiopia's membership by 2021 and noted its strategic role in the Horn of Africa. WTO accession will expand exports by providing the private sector with better market access, as 98 percent of global trade is between WTO members. But the authorities must address key issues such as governance of intellectual property and brand piracy by domestic firms. Adherence to a system of binding rules would attract foreign investment. A fair, predictable legal system that promotes trade and investment is among the priorities of the economic and legislative reforms.

[7] The initiative aims to promote regional infrastructure networks, trade and economic integration, resilience, and human capital development and is supported by African Development Bank, European Union, and World Bank.

Box 4.1: Potential benefits to Ethiopia from the African Continental Free Trade Area agreement

The African Continental Free Trade Area (AfCFTA) was launched in March 2018—and by January 2020, 54 of the 55 African Union member countries had signed the agreement. The AfCFTA establishes a single market for goods and services among member countries, which have a combined population of 1.3 billion in a $3.4 trillion economic bloc (IMF 2021b). Implementation of the AfCFTA agreement will deepen regional integration and expand intra-African trade, which stands at 17 percent of the continent's total trade. That is far below Europe (69 percent), Asia (59 percent), and North America (31 percent; Songwe 2021).

Increased intra-African trade will accelerate Ethiopia's industrialization, structural transformation, and transition to being a middle-income economy. Industrial development will raise living standards and reduce poverty and income inequality. Ethiopia will also benefit from increased value addition of goods and market access to countries and regions currently underused. The AfCFTA will enable Ethiopia to scale up its trade with other African countries, especially for products in which it has comparative advantages. In 2020 Ethiopia's exports to Africa accounted for 21 percent of the total, but for just 4 percent of products in which it has comparative advantages, such as coffee. Ethiopia has untapped export potential to Djibouti, Kenya, Somalia, South Africa, and Sudan, among others (ITC 2021). Agriculture accounts for the most products with untapped potential and can thus increase household income and reduce poverty.

4.3.2 Facilitators and Barriers to Regional Integration and Trade

Though Ethiopia aims to increase its exports to African and world markets, it lags in competitiveness. Limited competitiveness and a weak private sector limit manufacturing growth, job creation, and exports. Ethiopia ranks low on protecting minority investors, getting credit, and trading across borders. It takes up to 194 hours, at a cost of $750, for traders to comply with import documents—compared with the Sub-Saharan average of 96 hours at $287 (World Bank 2020a). (The imports measured here are 5 metric tons of containerized auto parts.) The Ethiopian Shipping and Logistics Services Enterprise (ESLSE) operates a monopoly market that does not incentivize lower prices and quality services. Being a landlocked, resource-poor country in a conflict-prone region exacerbates the factors constraining Ethiopia's trade.

Ongoing reforms by the Ethiopian Revenues and Customs Authority are raising compliance with international customs standards. These include the 2018 introduction of the electronic Customs Management System (eCMS) to ease certification of competency, trade registrations, and business licensing. Improvements in getting construction permits, registering property, and enforcing contracts have been achieved, ranking Ethiopia 67th of 140 countries of the World Economic Forum's 2019 Global Competitiveness Index (WEF 2020). But the country's overall score was 44.4 (of 100), putting it at 126th of 140 countries—far lower than the best-positioned Sub-Saharan countries: Mauritius (52nd) and South Africa (60th). Ethiopia scores particularly low on information and communications technology adoption (137th), skills (137th), and innovation capability (118th).

4.3.3 External Competitiveness

Ethiopia trying to establish a transparent, competitive trade system to satisfy consumers, traders, and investors within a fair and stable marketing system. The Trade Competition and Consumers Protection Authority is responsible for regulatory matters. In the past decade the authority has analyzed at least 1,900 primary markets `to create efficient, transparent, fair markets and enable

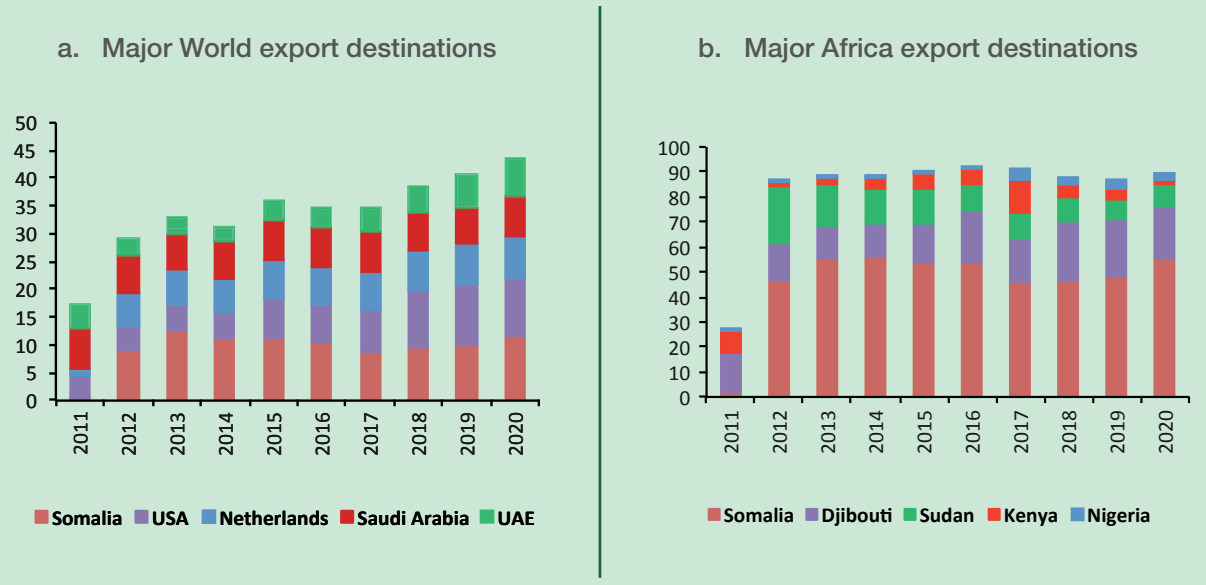
competitive pricing, efforts that are expected to expedite agricultural transformation. The Ten-Year Development Plan (2021-30) underscores strategies for making Ethiopia more competitive, including maintaining macroeconomic stability, boosting the competitiveness of agriculture and manufacturing firms by improving the investment climate, enhancing infrastructure access and quality, and identifying new sources of growth. Trade and investment activities are governed by national and sector strategies including the Industrial Development Roadmap, Industrial Development Strategy Plan (2013–25), Industrial Development Institutional Setup, Spices Export Strategy (2010), Review of Property and Trade Taxes (2019), and Ethiopia Trade and Transformation (2004).

4.3.4 Trade Flows

Asia, Europe, and the Middle East account for two-thirds percent of Ethiopia's merchandise exports and more than four-fifths of its imports. The country has concentrated export and import markets, with China as its biggest trade partner: in 2019 exports and imports of merchandise goods to and from China reached $3.6 billion (about 23 percent of Ethiopia's international trade). China dominates construction of public infrastructure (energy, roads, water projects) and is a major source of capital and intermediate goods for Ethiopia's budding industry. During 2016-20 Ethiopia's goods and services exports averaged about 8.0 percent of GDP, less than Kenya's 36.5 percent or Rwanda's 28.3 percent. Over 2020 and 2021 exports of services grew by an annual average of 22 percent due to the expansion of Ethiopian Airlines. But in 2020 the airline's earnings fell to 66.3 percent of service exports (from 72.7 percent in 2019) due to travel restrictions associated with COVID-19.

The main destinations for Ethiopia's exports of goods and services are Asia (42 percent), Europe (25 percent), Africa (21 percent), and the United States (12 percent). The main export destinations have changed over the past five years, indicating the importance of regional integration to scaling up trade and export revenue. Exports to Somalia increased from 0.2 percent of the total in 2011 to 11.6 percent in 2020 (figure 4.3a). The top export destinations outside Africa include the United States, Netherlands, Saudi Arabia, and United Arab Emirates. Within Africa, exports to Somalia jumped from 2 percent of the total in 2011 to 56 percent in 2020 (figure 4.3b). Other African destinations for Ethiopian exports include Djibouti, Sudan, Kenya and Nigeria.

Figure 4.3: Ethiopia's top export destinations, 2011-20



Source: ITC 2021.

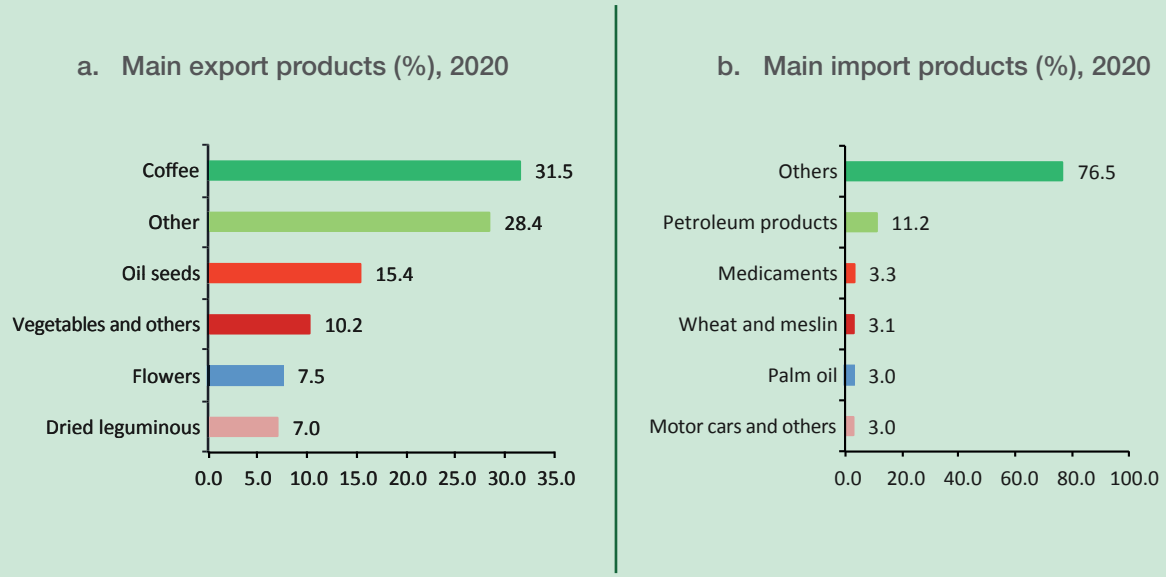
Asia accounts for 62 percent of Ethiopia's merchandise imports—dominated by China, which accounts for two-thirds of the regional total. The share of such imports from Europe was 21 percent, followed by the Americas at 10 percent, and Africa at 6 percent. Imports have slowed in recent years due to a decrease in foreign borrowing by state enterprises and a prioritization of public investment projects, as well as foreign exchange shortages. Between 2015 and 2019 the trade deficit dropped from 21 to 13 percent of GDP due to declining imports that more than offset declining goods exports. The trade deficit narrowed to 12 percent in 2020 due to lower imports.

Ethiopia has strong potential for tourism. In 2018 the country's tourism sector was the fastest-growing worldwide, with high potential to increase foreign exchange earnings (IFC 2019). During 2010-18 the number of tourist arrivals to Ethiopia grew 10 percent a year and tourism foreign exchange earnings rose 13 percent a year. Ethiopia ranked 122nd of 140 countries on the 2019 Tourism and Travel Competitiveness Index, and 18th of 34 Sub-Saharan countries (WEF 2019). Given its location in the Horn of Africa—with Addis Ababa hosting the African Union Commission, the UN Economic Commission for Africa, and the fact that Ethiopian Airlines connects Africa to other continents—Ethiopia has the potential to expand its tourism arrivals. But it ranks below the Sub-Saharan average on key enabling conditions such as business environment, human resources and labor market, information and communications technology readiness, prioritization of tourism, environmental sustainability, and infrastructure quality.

4.3.5 Trade Structure

In 2020 trade accounted for 24 percent of Ethiopia's GDP, up from an annual average of 17 percent during 2016-18 (WTO 2019). The main export products include coffee and oil seeds (figure 4.4a), and imports consist of petroleum products and manufactured goods (figure 4.4b). The largest sources of manufactured imports are the United Arab Emirates and United States.

Figure 4.4: Ethiopia's main export and import products, 2020



Source: ITC 2021.

Coffee and oil seeds were Ethiopia's main agricultural exports in 2020, while leather and t-shirts were the main nonagricultural exports. Wheat and meslin, palm oil, petroleum, and medicine were the main imports (table 4.1). Transportation of people and goods were the main service exports. Performance of agricultural exports remains low and revenue is vulnerable to global price variations and natural disasters. This has implications for the majority of the population given that agriculture employs more than 70 percent of the country's workforce.

Table 4.1: Ethiopia's top exports and imports of agricultural and nonagricultural products, 2020 (US$ millions)

Agricultural products			
Top exports	Value	Top imports	Value
Coffee	796	Wheat and meslin	431
Other oil seeds and oleaginous	388	Palm oil and its fractions	424
Other vegetables, fresh	259	Sunflower seeds	396
Cut flowers	190	Cane and beet sugar	338
Nonagricultural products			
Top exports	Value	Top imports	Value
Coffee	64	Petroleum oils other than crude	1,582
Other oil seeds and oleaginous	25	Medicaments in measured doses	469
Other vegetables, fresh	23	Motor vehicles for transport of people	417
Cut flowers	22	Motor vehicles for transport of goods	379

Source: ITC 2021.

Despite the steady increase in public infrastructure investments—from 5 percent of GDP in the early 1990s to 16 percent in 2020—the deficit remains large. Between 2017 and 2019 gross fixed capital formation ranged from 23-25 percent of GDP. Annual infrastructure investments of about 18 percent of GDP are required in roads, water, energy, and telecommunications during 2020-40. An estimated $40 billion is needed in 2020-30 for Ethiopia to achieve the targets for infrastructure set by the Sustainable Development Goals (SDGs). Though the state continues to play a heavy role through state enterprises in key sectors (telecom, finance, energy, logistics and transport, manufacturing), reforms to attract foreign capital and increase private investment are underway.

After almost two decades of public sector-led growth, Ethiopia is recognizing the missing role of the private sector—with ongoing reforms putting it at the center of its growth strategy. With more than 20 million people in extreme poverty and an estimated 2 million people entering the labor market each year over the next decade, there is an urgent need to create productive jobs to drive inclusive economic transformation. The government is investing in integrated agro-industrial parks to attract foreign investment in export-oriented manufacturing such as textiles and apparel, leather and leather products, and agroprocessing. Two such parks (Bole Lemi I and Hawassa) are operational and fully leased to investors.

Liberalizing telecommunications will help unlock the transformative power of the digital economy. The sector is controlled by the state-owned Ethio Telecom, with 44 million subscribers. In 2019 Parliament approved the Communication Service Proclamation Act, allowing for private investors both

domestic and foreign. In May 2021 the Global Partnership for Ethiopia, led by Safaricom of Kenya,[8] was granted a $850 million license to operate Ethiopia's second telecom network. The partnership is expected to invest $8.5 billion, create 1.5 million new jobs by 2030, support Ethiopia's digital transformation, attract further foreign direct investment, and enhance the lives of citizens. Bids are underway to grant a second license and sell 40 percent of Ethio Telecom's shares.

4.3.6 Regional Trade Reforms

To expand exports, Ethiopia can take advantage of its improving transport and energy infrastructure, low labor costs, and preferential market access to the European Union, United States, and other major markets. Ethiopia has large untapped markets in Africa and around the world. The country's unused potential for its five main export products, divided by the sum of potential exports, are listed in table 4.2—showing that Ethiopian exports can increase with the right policies and incentives. Despite coffee exports generating $768 million in 2020, the country has used only 24 percent of the potential Sub-Saharan market, with untapped potential in OECD (84 percent) and non-OECD countries (46 percent) as well. Ethiopian products are internationally competitive and have good prospects in these markets. Opportunities in domestic and export markets can be realized by addressing cross-cutting constraints that make it difficult for firms to invest and compete. Many of these challenges are already well known and subject to numerous initiatives undertaken by the government with the support of donors. But phytosanitary certificate requirements limit exports to the European Union.

Table 4.2: Ethiopia's unrealized potential for its five key exports

Product	Exports, 2020 (US$ million)	Unrealized potential (%)		
		Sub-Saharan Africa	Non-OECD countries	OECD countries
Coffee	767.8	76	54	16
Sesame seeds	435.1	81	39	47
Vegetables	268.3	41	46	93
Flowers	216.0	29	58	27
Goat meat	66.6	100	25	100

Source: ITC 2021.

Innovative investment promotion policies are needed to foster agricultural value chains, industrialization, manufacturing, and trade. WTO accession and active participation in the AfCFTA will expand export markets. To ensure that growth supports job creation and lowers poverty, increased focus is needed on creating more and better jobs for young people. To close skills and knowledge gaps, education polices at all levels should be revised to ensure that they are aligned with sector policies and to make sure that emerging sectors have access to skilled workers, especially in manufacturing and services.

Ethiopia has had relatively low COVID-19 infection, morbidity, and mortality rates, but the economy has

[8] Other members of the partnership include Vodacom Group, Vodafone Group, Sumitomo Corporation, and CDC Group.

suffered the effects of the global economic slowdown. Global demand for flowers fell 80 percent in 2020, causing Ethiopia to lose $200 million in flower exports and putting at risk more than 50,000 jobs. Ethiopian Airlines was quick to adjust its business model and convert several passenger aircrafts to transport cargo across the world. That helped the airline—which contributes about 5.4 percent of GDP and employs over 1.1 million people (directly and indirectly)—remain afloat and maintain its entire workforce. Textiles, which had become the country's sixth largest export earner, were also hit hard by COVID-19. A fall in external demand led nearly 14,000 workers to be put on leave in one of the large industrial parks. To mitigate the impact, firms in industrial parks shifted to producing personal protective equipment including masks, sanitizers, and protective suits.

4.4 Energy

4.4.1 Energy Resources, Infrastructure, Supply and Demand

Ethiopia's goal of achieving universal access to electricity by 2030 aligns with the Bank's High 5 to Light Up and Power Africa. Large generation, transmission, and interconnection projects are supporting this effort. The National Electrification Program, introduced in March 2019, aims to extend grid connections to 65 percent of the population by 2025. Key operational targets include connecting 15 million households to the national grid, increasing rural household connections by 8 million through solar systems and isolated mini- and microgrids, and creating cross-sector links in the productive and service sectors.

Only 44 percent of the population had access to electricity by 2020 (33 percent from the main grid and 11 percent using offgrid technologies). Per capita electricity consumption is 92 kilowatt-hours, less than a fifth of the African average. Large income and geographic disparities in access persist: almost 96 percent of the urban population is connected, compared with 27 percent in rural areas. Offgrid access is supported by 35 diesel-fueled minigrids run by the Ethiopian Electric Utility and 2 renewable-based minigrids run by private developers. The national power supply system is the publicly managed grid. It receives over 90 percent of its energy from hydropower (4,064 megawatts), wind (324 megawatts), and waste-to-energy sources (25 megawatts). But many new hydro, wind, and geothermal power projects are under construction, as are power purchase agreements with private developers.

A draft 10-year power system expansion plan forecasts demand for electricity to grow by 13.7 percent a year through 2030 to reach 57,000 gigawatt-hours—more than four times the 13,800 gigawatt-hours in 2020. This massive increase reflects growth in demand for energy exports, industrial use, irrigation, and transport (railways), as well in growth of demand from businesses and households. To meet this growing demand, cumulative generation capacity should be increased to 17.1 gigawatts by 2030. Projects to generate about 10 gigawatts are ongoing, with plans for another 3 gigawatts of new projects being discussed. All planned new generation will be from renewable sources in line with the government's strategy for clean energy. To reduce overdependence on hydropower, the goal for 2030 is to increase the share of solar, wind, and geothermal to 25 percent and reduce the share of hydro to 75 percent (from the current 95 percent). Financing for greenfield power generation projects is expected to come from long-term power purchase agreements with independent power producers.

4.4.2 Actual and Potential Energy Endowments

Ethiopia has vast renewable energy resources, most of which remain untapped. Key potential resources include a technically exploitable 48,000 megawatts of hydropower from eight river basins, 5,000-10,000 megawatts of geothermal in 24 locations, potential wind energy of 1,350 gigawatts, and solar irradiation of 2,100 kilowatt-hours per square meter per year (on average). Nonrenewable sources include sustainably exploitable wood resources of 1.1 billion metric tons, agriculture residue of 15-20 million tons, and fossil fuel resources including 226 billion cubic meters of natural gas, 300 million tons of coal, and 253 million tons of oil shale reserves. In 2019, 14,544 gigawatt-hours of electricity was generated (and 10,558 consumed), up from 8,792 generated (5,435 consumed) in 2014 (FDRE 2021).

By 2025, when energy projects under implementation come onstream, total installed capacity is expected to exceed 15,000 megawatts. Growth in installed capacity will

increase Ethiopia's electricity exports to Djibouti, Kenya and Sudan. Progress on electrification is encouraging, with the number of connections to the national grid nearly quadrupling from 800,000 in 2005 to more than 3 million in 2020. In addition, several hydropower-based minigrids have been developed with assistance from development partners and are run by local electricity cooperatives, along with standalone household solar systems. About three-quarters of households depend on firewood for cooking, contributing to environmental degradation and indoor air pollution (FDRE 2021).

Ethiopia is becoming a major power exporter to Djibouti and Sudan through 230-kilovolt transmission lines. In 2019-20 Ethiopia's electricity exports to the two countries averaged 970 gigawatt-hours, earning $56 million a year. Ethiopia also exports power to two border towns in Kenya. Ongoing investments in power interconnections will expand exports through a second 230-kilovolt line to Djibouti and a new 500-kilovolt high voltage line linking Kenya to greater East Africa upon completion of the Grand Ethiopian Renaissance Dam. Interconnectors with South Sudan and Sudan are also planned.

4.4.3 Energy Laws and Institutions

Energy laws and regulations are defined by legislation, policies, and strategy papers. The Ministry of Irrigation and Energy provides leadership of energy development, including planning, coordinating, and monitoring specialized federal institutions. The Ethiopian Energy Authority, established in 2014, regulates the sector and provides oversight and licensing across the entire value chain, including for private participation in generation. The National Electrification Program, launched in 2017, aims to achieve universal access to electricity by 2025. Though state enterprises dominate the sector, reforms are underway to allow private participation in generation. The Ethiopian Electric Power Corporation is responsible for electricity generation, transmission, and bulk sales (including exports), while the Ethiopian Electric Utility is responsible for distribution and connections. The Alternative Energy and Technologies Development and Promotion Centre promotes the adoption of small-scale energy production technology and energy-efficient appliances. Regional governments have their own energy bureaus to implement local energy access programs.

The 1994 National Energy Policy (under revision) seeks to increase access to reliable, affordable modern energy through the use of clean, efficient technology. Two pillars of the Climate Resilient Green Economy strategy relate to energy: committing to generating electricity only from renewable energy sources and using modern, energy-efficient technology in transport, industry, and buildings. The 2014 Energy Proclamation defines the national legal framework for electricity and energy efficiency as well as the powers and duties of the Ethiopian Energy Authority (the regulator). The 2019 Energy Regulation deals with licensing, certification, rights, and obligations of energy developers as well as grid access. That regulation also provides for energy efficiency and conservation based on international standards. The 2016 Geothermal Resources Development Proclamation defines upstream and downstream geothermal development activities. Finally, the 2018 Public-Private Partnership Proclamation established the framework for private investment in infrastructure projects, with energy as one of its targets.

4.4.4 Energy Strengths, Weaknesses, Opportunities, and Threats (SWOT Analysis)

Ethiopia's development strategies prioritize energy development, and over the past decade major progress has been made in expanding generation capacity and grid services to previously unserved areas. These efforts have expanded access to modern, affordable, reliable energy and supported industrialization. Domestic finance was used for energy generation, transmission, and distribution projects. Now the government is tapping into foreign finance, including grants as well as commercial and concessional debt from bilateral and multilateral sources.

Diversifying the mix of power generation will leverage Ethiopia's unique endowments of solar, wind, and geothermal resources to make energy more reliable. Opportunities exist in developing these renewable energy sources to lower the cost of electricity while aligning with the goals of the green growth strategy, fortifying a carbon-free power sector, and meeting Ethiopia's Nationally Determined Contributions to mitigate climate change. Integration of East Africa's power systems offers Ethiopia the opportunity to increase its exports of clean energy and ancillary services—contributing to foreign exchange earnings and improving

the balance of payments. Exploiting Ethiopia's abundant renewable energy, especially for off-grid and standalone solar systems, could create jobs. Demand for solar power is expected to continue growing, consistent with the National Electrification Program's goal of expanding rural electrification to 35 percent by 2025 through off-grid solutions.

Achieving universal access to electricity will be a major challenge. More than half of Ethiopia—60 million people—has no access to electricity, placing it among the top five countries with the biggest access deficits. For lack of skills, the Ethiopian Electric Power Corporation and Ethiopian Electric Utility have limited capacity to design and implement policies and regulations. Applying modern technology and corporate culture as well as rehabilitating and upgrading physical assets would improve business processes and service delivery. But financial market weaknesses and chronic foreign exchange shortages limit the scope to finance energy investments at the scale and rate required to achieve the country's goals for 2030.

Energy generation and distribution require more private participation. Though power generation was opened to private independent power producers in the early 2000s, investors did not respond because tariffs were low and laws and regulations had gaps. In addition, most private investors complain about currency inconvertibility and controls on foreign exchange repatriation. The government is trying to address these issues to create a conducive environment for private investment. Participation by private providers in the offgrid space is also weak due to regulatory ambiguities and expectations of low tariffs (on par with national grid tariffs) by rural communities. The revised energy regulations have addressed some of these issues, and the first private minigrids have started operations.

Threats include climate change and unsustainable financing. Climate change models predict that increasing extreme weather events will lead to more frequent and severe floods and droughts, threatening hydropower supplies. Thus adaptation measures are urgently needed, including diversification of energy sources to reduce dependence on hydropower and improving the energy mix. The relative success in mobilizing public finance (domestic and external) for energy investments may not be sustained due to rising national and energy sector debt. Keeping electricity tariffs below costs for so long has limited revenue, contributing to debt accumulation and inefficiencies. In 2019 energy sector debt was estimated at 15 percent of GDP.

COVID-19 has added to the challenges, resulting in calls to accelerate ongoing initiatives. The pandemic underscored the importance of access to electricity for households, education and health providers, and other public institutions to strengthen community resilience and continuity of services. At the same time, the pandemic-induced slowdown in economic activity temporarily reduced electricity demand. The SWOT analysis is summarized in table 4.3.

Table 4.3 Strengths, weaknesses, opportunities, and threats for Ethiopia's energy sector

Strengths	Weaknesses
• Tariff reform program with annual adjustments for cost-effectiveness. • Legal framework for public-private partnerships for infrastructure development. • Extensive renewable energy resources for carbon-neutral development. • Large population offers large market and demand for energy.	• Weak financing for energy investments. • Foreign currency shortages discourage private investments. • Poor regulation for private investments. • Inadequate coordination between energy sector players. • Inadequate governance structures.
Opportunities	**Threats**
• Job creation through decentralization of offgrid energy generation in different markets. • Improved living standards and welfare in communities. • High regional reserves of water sources for energy generation.	• Exposure to climate change effects. • Dependence on hydropower threatened by climate change, with frequent floods and droughts. • Rising public debt limits fiscal space. • Conflict and civil unrest deter investment.

4.4.5 Latest Policies for and Interventions in Energy

To address the evolving challenges—including high public debt and limited financing options—the government is taking steps to sustain energy growth. These include:

- Implementing tariff reform, with annual adjustments from 2018-21 to improve the sector's financial health. The cost of electricity rose from less than $0.02 per kilowatt-hour in 2017 to $0.04 in 2020.
- Decentralizing the Ethiopian Electric Utility to make service delivery more efficient.
- Modernizing institutions to boost business efficiency.
- Rehabilitating and upgrading transmission and distribution networks to reduce power losses.
- Introducing public-private partnerships for infrastructure development. This framework has already injected private finance and knowhow into infrastructure projects.
- Revising laws and regulations to cover both supply and demand.

A comprehensive review is underway of energy policies and power reforms through 2030. The reforms are being led by the ministries of water, energy, and finance. Key elements include further unbundling the Ethiopian Electric Power Corporation to separate generation from transmission and identify areas for privatization. For the Ethiopian Electric Utility, geographic unbundling into 11 distribution companies aligned with national administrative divisions is being considered. But privatization of transmission and distribution does not seem to be on the agenda. Measures are ongoing to restructure public energy debt and increase revenue. But a strategy is needed to improve service quality, covering both technical (including network losses) and commercial services.

4.4.6 Proposed Interventions by the African Development Bank

The Bank's energy portfolio in Ethiopia focuses on investments in national and regional transmission construction, distribution network rehabilitation, and expansion of access to rural populations. The Bank could support investments in transmission lines (especially those serving industrial parks and new load centers), upgrading transmission and distribution networks, and promoting the use of modern technology. Such efforts would leverage the Bank's role and competencies in the energy sector to respond to the growing demand for electricity.

Investments that increase electricity access in underserved, mostly rural areas would contribute to the National Electrification Program goal of universal access. The Bank should sustain investments in cross-border power interconnections as well as measures to improve domestic manufacturing capacity for electrical equipment. These moves would help Ethiopia achieve its vision of becoming a regional energy hub, generate foreign currency, and create jobs. Ethiopia's comparatively cheaper electricity will lower costs among its neighbors and improve power access and reliability, reduce carbon footprints.

The Bank should sustain support to private independent power producers through non-sovereign operations for viable projects and risk guarantees. The Bank should maintain engagement with the government to support policy reforms that attract investment in transmission, distribution (ongrid and off), and operations and maintenance. The Bank can support the preparation of laws and regulations that align with the changing environment and institutions that will be affected by policy reforms.

At least three areas call for Bank engagement in policy dialogue on Ethiopia's energy sector. First, the Bank should support policy dialogue on power reforms to increase private investment and participation, leverage expertise, and bridge financing gaps. Before a bulk power competitive market is introduced, dialogue is needed on required institutional competencies and sector efficiencies. Second, the Bank should support policy dialogue on public-private partnerships, including prioritization and sequencing of energy projects to attract private finance to the sector. Third, policy dialogue is needed on financial sector and foreign currency regulations and their impact on the energy sector. That includes the need for a trust fund to help private investors access foreign currency for investments, pay offshore debt, and repatriate profits. The proposed areas for Bank engagement would also help Ethiopia achieve universal access to clean, affordable electricity by 2025.

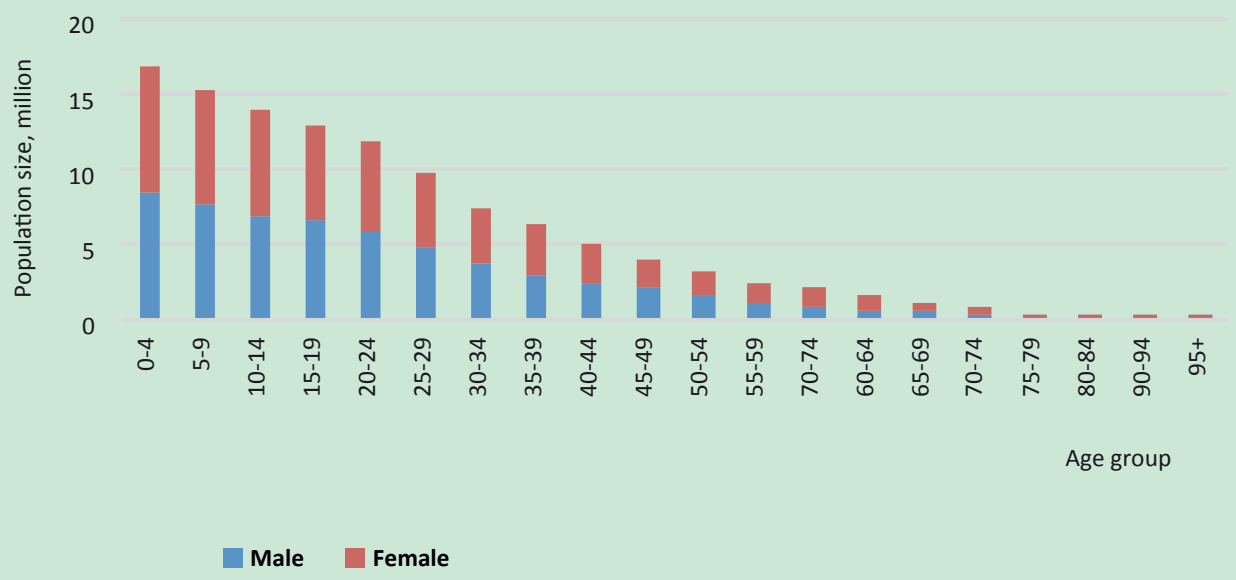
4.5 Social Concerns

Ethiopia has made substantial socioeconomic progress over the past two decades. The share of people living below the national poverty line fell to 23.5 percent in 2016. But poverty and food insecurity remain widespread: at least 15 million people require food support. Rural households are more prone to food insecurity than urban ones. Drought is an immediate cause of rural food insecurity, since it has serious repercussions for food access and availability. Low incomes, demographic factors, and weather shocks also drive food insecurity. Food insecurity's root causes include structural factors such as environmental degradation, population pressure (resulting in land fragmentation), and use of outdated technology (leading to poor agricultural performance). Limited income sources and high unemployment also contribute to food insecurity. Consecutive droughts in many parts of Ethiopia have stretched household resilience and weakened coping capacity. Finally, the land policy does not provide full ownership rights, impeding investments.

4.5.1 Education, Skills, and Jobs

Almost 70 percent of Ethiopians are under 30, making the country one of the most youthful in Sub-Saharan Africa (ILO 2020a; figure 4.5) Between 1990 and 2020 the total fertility rate per woman of childbearing age plunged from 7.2 children to 4.3, yet annual population growth remains high at 2.7 percent. Only 38 percent of married women use any form of contraception. The working-age population is estimated at 55 million (69 percent of the population) and is expected to grow to 75.4 million by 2025. Access to education has increased across all levels. In 2020 primary school net enrollment was estimated at 97.0 percent, up from 73.3 percent in 2010. Similarly, the grade 8 completion rate rose from 47.8 percent in 2010 to 62.1 percent in 2020. To benefit from its demographic dividend, Ethiopia needs more awareness about family planning, skills development through education, and faster job creation.

Figure 4.5: Ethiopia's population distribution by age group and sex, 2021



The low quality of education is a challenge for human capital development and employability, especially for youth. Increased participation in primary education has not been accompanied by quality learning outcomes. Primary and secondary school graduates lack the knowledge and skills required to participate in the labor market. Education infrastructure, facilities, and materials are inadequate, affecting the quality of education. Poor education planning and low quality of teachers and school administration further undermine the quality of learning. Steps being taken by the government include continuous professional development and standardization through certification or licensing of teachers and revisions to the curriculum. Strong collaboration with the private sector is needed to produce the skills required for inclusive growth.

The transition from primary to secondary school is limited. Only about 32 percent of children transition to secondary education. This is partly due to limited physical access to secondary schools and financial and social barriers, particularly for girls. The number of secondary schools is limited relative to primary schools—37,039 versus 3,739—and most secondary schools are in urban centers. Regional variations also exist in access to secondary school, emphasizing the need to expand capacity and bring schools closer to communities.

While overall unemployment is relatively low, at 5 percent in 2020, that masks spatial and social disparities. Urban unemployment was estimated at 19.1 percent in 2020 (up from 16.5 percent in 2013) and rural unemployment at 2.5 percent. Almost 82 percent of the labor force lives in rural areas and is engaged in agriculture, mostly as self-employed and unpaid family workers. In urban areas the deficit of productive jobs takes the form of working poor, disguised, and open unemployment. Urban unemployment increased among youth and is estimated at 25.3 percent (31 percent among women and 19 percent for men) and will likely continue to rise due to rural-urban migration.

Sustainable job creation is a critical challenge for Ethiopia to meet labor market demand and the goal of becoming a middle-income country by 2025. Ethiopia needs to create 14 million jobs between 2020 and 2025 to absorb new entrants to the labor market and the current backlog of unemployed. An estimated 2 million people enter the labor market each year with limited opportunities of finding descent work—a situation that COVID-19 will only worsen. Some 5 million additional young people are not in employment, education, or training, indicating social exclusion and extreme vulnerability in the labor market (ILO 2019).

The government is strengthening institutional capacity and the policy environment to promote job creation. The Job Creation Commission, established in 2018, aims to facilitate the creation of 14 million jobs by 2025 and 20 million by 2030. The commission's 5-year action plan and 10-year roadmap identify agriculture, mining, tourism, and information and communications technology as key sectors for expanding employment. Coordination and monitoring structures have been established to create jobs, including the National Investment and Job Creation Core Committee led by the prime minister and comprising all ministries, federal and regional joint steering committees, regional presidents, and city administration mayors.

Vulnerable, precarious forms of employment result in working poverty. Most job opportunities are in the informal economy—including construction, where many jobs are low skill and temporary. Most people moving out of agriculture end up in low-paying informal jobs. Micro, small, and medium-size enterprises provide the majority of jobs, especially in urban areas, and most operate informally. Almost 39 percent of Ethiopia's GDP comes from the informal sector, underpinned by self-employment (World Bank 2019b). Informal jobs are characterized by low skills, lack of legal and social protection, and limited opportunities for training and career progression. Adoption of technology and innovation is minimal, inhibiting competitiveness and productivity. Informality leads to vulnerability to shocks, adversely impacts jobs, and the incomes of the self-employed who survive at subsistence levels. Thus, working poverty remain pervasive, with a large share of households earning less than what is needed to survive. Lack of a labor market information system makes it hard to provide targeted solutions for youth employment.

Access to finance is a major challenge for the start-up and growth of enterprises and for private employers in general. Ethiopia scored 3.7 of 7 and ranked 124th of 141 countries on financial market development in the World Economic Forum's 2019 Global Competitiveness Index

compared with 3.4 of 7 and 109th of 137 countries in 2018 (WEF 2020). And 40 percent of enterprises cited access to finance as a major constraint to their expansion in the World Bank survey (World Bank 2021c). Though the private sector accounts for 52 percent of wage employment, it receives only 36 percent of domestic credit (FDRE 2021). Youth participation in economic activities is limited by inadequate access to land and credit.

Expansion of productive employment is hampered by weak laws and policies, low innovation, and the lack of an effective labor market information system. Ethiopia lags its peers in East Africa on enabling reforms for digital banking, digital payments, e-financial services (including credit and insurance targeting farmers, retail consumers, and micro, small, and medium-size enterprises), and e-commerce platforms (suppliers/clients-to-farmers, business-to-business, business-to-consumer). This bottleneck on service delivery became more of an issue due to COVID-19. Business development services must be strengthened to provide demand-driven skills and promote entrepreneurship. Reforms are needed to strengthen the labor market to promote productivity, competitiveness, and entrepreneurship. According to the Job Creation Commission, the absence of strong labor market institutions and information leads to excess reliance on social networks, hindering social and labor mobility and misallocating labor.

Labor market skill mismatches are widespread. Available skills do not match labor market demand in terms of quality, competencies, or skill sets, forcing investors to outsource required skills. The skills mismatch, estimated at 33 percent, obstructs pathways to gainful employment (AfDB 2020b). Ethiopia has moved in the right direction by identifying skills gaps in different growth sectors. Addressing the skills mismatch requires, among other things, expanding access to technical and vocational education and training and linking the supply (education and training) and demand (enterprise development) sides of the labor market. The Education Development Roadmap 2018-30 aims to improve education and address inefficiencies in the system. The Ministry of Science and Higher Education was established in 2018 to lead the development of science, higher education, and technical and vocational education and training. Vocational training is guided by the 2008 National Technical and Vocational Education and Training Strategy, which aims to develop demand-oriented training to meet the needs of the private sector.

Ethiopia's score on the World Bank's human capital index has stayed at 0.38 since 2017—below the 0.48 average for lower-middle income countries (World Bank 2020b).[9] A child born today in Ethiopia will achieve 38 percent of his or her human capital development at 18 years, below Kenya (55 percent), Ghana (45 percent), and South Africa (43 percent). The outbreak of COVID-19 in March 2020 and associated closure of schools might exacerbate weak learning outcomes and human capital development.

4.5.2 Poverty and Inequality

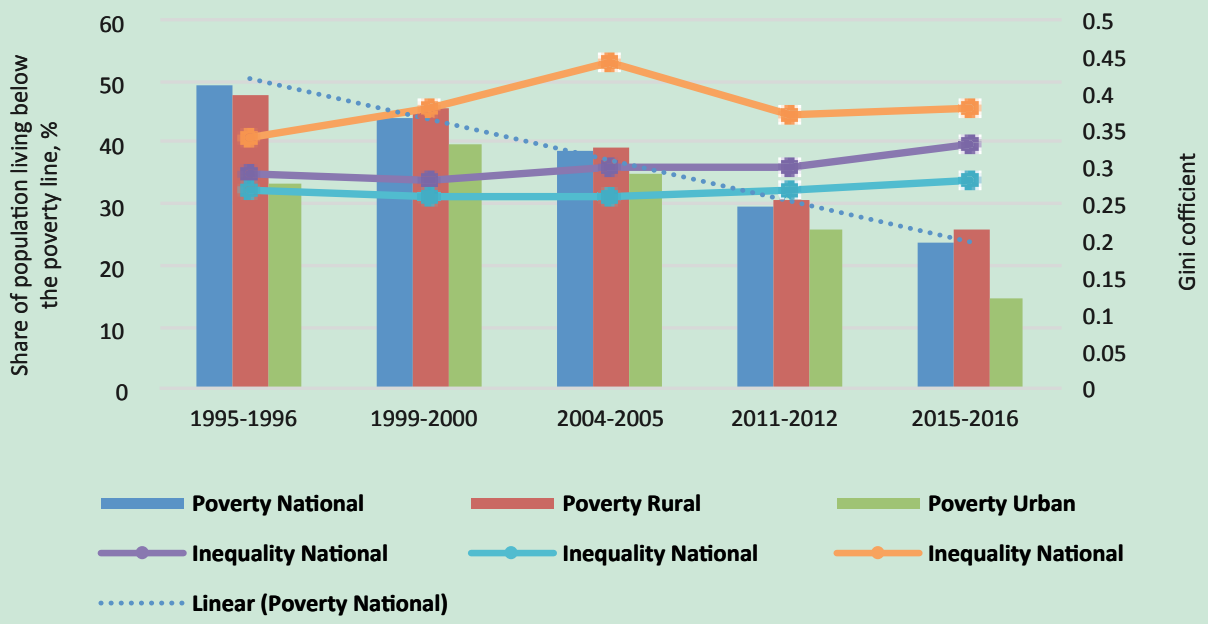
Ethiopia has made strides in reducing poverty, buffeted by high economic growth and pro-poor spending. The share of people living below the national poverty line nearly halved between 2000 and 2016, from 44.2 to 23.5 percent (figure 4.6). The multidimensional measure of poverty also fell during that period, from 88.4 percent to 83.5 percent (UN 2020). The Ten-Year Development Plan (2021-30) projects that poverty will continue declining, to 14.8 percent by 2026 and 7.0 percent by 2030. Meanwhile, life expectancy at birth jumped from 56.2 years in 2005 to 66.7 in 2020, reflecting better access to and quality of health, education, water and sanitation, and employment. The country's broadly based development strategies and pro-poor public spending help explain this progress.

Expanded access to social services and protection and gains in human capital have reduced rural poverty and improved livelihoods. The Rural Productive Safety Net Program supports 8.4 million people in food-insecure parts

[9] The index measures, on a scale of 0-1, the level of human capital a child is expected to attain by age 18 and conveys important information on the next generation of the workforce.

of Ethiopia. Between 2005 and 2019 under-five mortality declined from 123 to 55 deaths per 1,000 live births and child stunting fell from 47 to 37 percent. Still, Ethiopia remains a low human development country, scoring 0.485 on the 2020 Human Development Index and ranking 173rd of 189 countries (UNDP 2020). Because of its large population size and growth rate, shocks, and conflict, the number of people in poverty and requiring humanitarian support continues to increase (WFP and CSA 2019; National Bank of Ethiopia 2021). With a Gini coefficient of 0.33 in 2016, inequality is low relative to other African countries but has risen from 0.28 in 2000 (see figure 4.6). Poverty is higher among rural households (25.6 percent in 2016 compared with14.8 percent among urban ones), households with high dependency rates, those headed by older and less-educated individuals, and those engaged in agriculture and casual labor (World Bank 2020b). Diversifying sources of livelihood and improving access to social services would help cut poverty faster.

Figure 4.6: Trends in poverty and income inequality in Ethiopia, 1996-2016



Source: FDRE 2021.

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Progress is mixed at the regional level. During 1996-2016, progress was strongest in the SNNPR and Harari regions, with poverty declining by about two-thirds (AfDB 2020e). Poverty reduction was also high in the pastoral areas of Benishangul, Gambella, and Somali, falling from 32 percent in 2011 to 18 percent in 2016. Poverty has fallen slower in arid lowlands and regions affected by droughts and instability. These regions also report low human capital due to limited access to and poor quality of basic services. In 2016 Amhara, Oromia, and the SNNPR were home to over 80 percent of Ethiopia's poor people because of their large populations. The incidence of wasting is higher in lowlands, with Somali reporting the highest level as 23 percent, followed by Afar (18 percent), Gambella (14 percent), Benishangul-Gumuz (12 percent), and Oromia (11 percent). The national level is 9.9 percent (AfDB 2020e).

In 2020 COVID-19 and other shocks increased the number of people requiring humanitarian support and social protection to 15 million—nearly twice the 8 million in 2019. These shocks were also heightened by conflicts and the desert locust invasion. Urban households that rely on self-employment experienced severe income losses. Fiscal constraints arising from COVID-19 and conflicts will adversely affect delivery of basic services, potentially compromising the human development gains made so far. Advocacy for improved child nutrition is needed including encouraging diversity of food items consumed. Efforts are also needed to expand the reach of social safety nets to support households experiencing food insecurity.

4.5.3 Water and Sanitation

The Ministry of Water and Energy is responsible for policies and laws to develop water resources. The 1999 Water Resources Management Policy is being revised to emphasize the need for sustainable management of water resources to accelerate socioeconomic development, defining water as a strategic resource. The draft National Water Policy and Strategy of 2020 focuses on promoting sustainable water use and security through surface and groundwater development, building water-regulating hydropower infrastructure, expanding water buffer management, enhancing environmental conservation, and using modern technology in water resource management and service delivery. The draft also promotes the need for improving governance by regulatory institutions, establishing basin institutions, and addressing climate change. The national policy will guide regional states in developing water strategies and guidelines for sustainable management.

Access to safe water is improving but large disparities persist. In 2021, 60 percent of the population had access to safe drinking water, up from 45 percent in 2015. That implies that nearly 70 million people now have access, from about 45 million in 2015. But 63 percent of the urban population has access—compared with 57 percent in rural areas. And just 30 percent of health facilities have improved water sources. Findings from a 2021 national inventory underscores the gaps and inequalities in water and sanitation access. Gaps in provision of water and sanitation are mainly caused by low public spending relative to other social sectors.

Access to improved sanitation is a major challenge, with adverse implications for health—especially during emergencies such as COVID-19 and floods. Only 21 percent of the population has improved sanitation, while 28 percent has no sanitation facilities. Limited access to safe water and sanitation, along with poor hygiene, accounts for 60-80 percent of communicable diseases. During 2015-21 at least 5 million Ethiopians accessed improved water and sanitation through Bank-financed projects.

4.5.4 Health System Strengths

The government implemented four Health Sector Development Plans and a Health Sector Transformation Plan (FDRE 2015) to operationalize its 1993 health policy. The 2019 Essential Health Service Package aims to deliver quality universal health services to all Ethiopians regardless of their socioeconomic status. The package's innovative policies and increased investments have substantially improved health outcomes. Ethiopia achieved Millennium Development Goal 4 (reducing under-five mortality) three years before the deadline. Similarly, infant mortality fell from 77 to 43 deaths per 1,000 live births between 2005 and 2019. The share of live births delivered by a skilled provider increased from 28 percent in 2016 to 50 percent in 2019. Maternal mortality plunged from 676 per 100,000 live births in 2009 to 354 in 2019, and the rate of antenatal care (at least one visit) rose from 62 percent

in 2016 to 74 percent in 2019 (FDRE 2021). In rural areas that rate doubled from 21 to 43 percent. The share of women age 15-49 reporting distance from health facilities as a constraint to accessing health care dropped from 66 percent in 2011 to 50 percent in 2019 (AfDB 2020d).

The government recognizes that investing in nutrition is critical to becoming a middle-income country by 2025. This focus is reflected in the Ten-Year Development Plan, 2021-30, which seeks to reduce the prevalence of stunting among under-five children from 37 percent in 2019 to 26 percent by 2030. This goal is also reflected in the 2018 National Food and Nutrition Policy and 2016-20 National Nutrition Program II. The latter emphasized ending chronic malnutrition through a multisector approach. In 2015 the government signed the Seqota Declaration to end stunting among children under two by 2030.

Still, the burden of diseases remains high, with low quality and equity of services. Pastoral areas and historically underserved regions of Afar, Benishangul Gumuz, Gambela, and Somali report low performance on many health indicators. In urban areas 70 percent of births occur in health facilities, compared with 40 percent in rural areas.

Challenges in delivering equitable, quality health service include limited institutional capacity, inadequate staffing, and poor infrastructure due to overstretched budgets. In 2019, 12.2 percent of the national budget was allocated to health while regional government budget allocations ranged from 3.9 percent in Dire Dawa to 15.8 percent in the SNNP. COVID-19 has compounded health challenges. The pandemic diverted resources and attention from regular services like maternal and child health, and community outreach services were compromised. Some 28 percent of child mortality and 16 percent of repetitions in primary school are associated with stunting due to undernutrition (World Bank 2020b).

The government is investing in health services, with a focus on transforming the quality of healthcare. The health sector faces constraints in both supply (including low quality and long distances) and demand (low incomes and limited access to financial services). To address these, the government is implementing the Community-Based Health Insurance scheme and a fee waiver system. Constraints on mobility resulting from conflicts or distance to health centers and costs of transport disrupt service provision and health-care-seeking. Hygiene is a major gap in emergency and nonemergency settings alike.

CHAPTER: PRIORITY REFORMS

5

5.1 Introcuction

This chapter identifies priority policies for achieving Ethiopia's development goals—led by the sustained, inclusive growth and poverty reduction needed for structural transformation and middle-income status. The reforms suggested are linked to the African Development Bank's High 5 agenda (see chapter 4). Policy priorities include accelerating economic reforms to eliminate market distortions, expediting investments in enablers of structural transformation (human capital, infrastructure, institutions), boosting agricultural production and productivity, increasing the private sector's role in the economy, scaling up industrialization and manufacturing, expanding trade and regional integration to increase exports, and harnessing the potential of tourism and urbanization. The do no harm and leave no one behind principles must be applied throughout so that interventions help strengthen social cohesion, peace, and stability. Key areas for possible Bank interventions are highlighted in box 5.1. A monitoring and evaluation assessment of development outcomes is included in annex 4.

Box 5.1: How can the African Development Bank support Ethiopia?

Over the medium term the Bank could consider support in three broad areas: macroeconomic and financial sector reforms, investment in growth enablers, and improved governance for the expansion of service delivery and facilitation of private sector growth. These areas are critical to addressing sectoral bottlenecks and unlocking structural transformation. The proposals for possible areas for Bank support are informed by various criteria, including the need to build on and consolidate ongoing Bank-financed interventions, support Ethiopia in harnessing emerging development opportunities, and achieving the ambitions of the Ten-Year Development Plan, 2021-30.

Macroeconomic and financial sector reforms. The Bank could continue supporting macroeconomic and financial sector reforms to ensure inclusive, sustainable growth and resilience to shocks. Sustained dialogue on macroeconomic issues—including public debt and inflation analysis and management, and technical assistance to deepen financial sector reforms and develop capital markets—are important to lay the foundation for efficient financial intermediation, financial inclusion, and sustained growth. The Bank could continue dialogue and technical support on the need for increased use of policy-based monetary tools (such as the Open Market Operations and Standing Facilities) to enhance the effectiveness of monetary policy.

Investment in growth enablers. Bank investment in growth enablers such as infrastructure, human capital, and institutions would help address structural imbalances and position Ethiopia to benefit from both domestic and external markets.

The Bank could build on ongoing road and energy interventions to consolidate the development of sustainable road networks and energy generation and transmission systems to facilitate increased production and exports. Support could be provided through investment projects and advocacy for an improved enabling framework for private investments to expand road construction and electricity generation and transmission through public-private partnerships. Support for operations like industrial parks and integrated agro-industrial parks could be scaled up to advance high value-added production and expand job creation. In agriculture the Bank could support the development and application of appropriate technologies, market information, related off-farm activities, value chains to expand production, and increased productivity for food production and exports.

Improved governance for the expansion of service delivery and facilitation of private sector growth. The Bank could support expansion of the private sector's role in the economy, including by conducting surveys, generating knowledge, and providing technical assistance. Dialogue to promote private participation in all stages of the value chain and logistics management would be strengthened. The Bank needs to continue supporting trade facilitation and capacity building to streamline nontariff measures and border clearance processes for Ethiopia to fully benefit from the AfCFTA agreement and regional trading blocs. The Bank could build on its approach of decentralized basic services to support skills development by sustaining dialogue on equitable, quality basic service delivery, public spending on pro-poor activities, and promotion of transparency and accountability. Through the Basic Services Transformation Program and in coordination with other development partners, services in underserved regions could be improved and the lowest-performing districts could be prioritized. The Bank could also support health infrastructure, systems development, and community-based health insurance to increase Ethiopia's capacity to respond to public health emergencies and minimize out-of-pocket expenses. In addition, the Bank could support the national commitment to invest in child nutrition by taking a multisectoral approach and through water and sanitation projects. Finally, the Bank could support capacity strengthening for urban planning and provision of services such as urban water and sanitation management.

Future Bank operations will maintain dialogue, knowledge generation, and technical assistance on macro and social development issues to promote inclusive growth, peace and stability, and resilience building. Bank operations will support statistical capacity building to gather and analyze disaggregated data to improve monitoring and evaluation of Bank-financed projects. The Bank will work with other development partners and regional economic communities to advocate for synchronized data collection programs that facilitate country comparisons. Sensitization programs will target high-level decisionmakers to allocate more resources for statistics and implementation of the National Strategy for the Development of Statistics. Through its Africa Information Highway—an innovative data platform that informs the Sustainable Development Goals agenda and disseminated key macroeconomic indicators (including debt statistics)—the Bank is supporting data management and dissemination systems as well as publication of national summary data pages for 30 countries, including Ethiopia.

5.1.1 Accelerating Economic Reforms to Eliminate Market Distortions

Prudent macroeconomic policies are essential to ensuring inclusive, sustainable growth and resilience to shocks. Ethiopia needs well-developed fiscal and monetary policies and capacity strengthening to ease uncertainty. Better foreign currency management through a transition to a market-determined exchange rate will be critical to raising foreign direct investment and remittances. The fiscal authorities should improve their capacity for public debt management to help reduce and diversify public debt. Doing so will ensure

that the country's debt-carrying capacity is sustainable as the government continues its development agenda. The National Bank of Ethiopia should focus on mitigating inflation through fiscal and monetary instruments.

Phasing out capital outflow controls and lifting financial repression and capital inflow controls could lead to 2.5 percent annual growth in real GDP over the next 10 years. The sustained gains would come from increased financial resources available to the private sector from reduced lending to state enterprises and from increased foreign investment. Liberalizing capital outflows alone in a context of financial repression can hurt growth because the outflow of savings could drive up domestic interest rates and raise borrowing costs for the private sector. Ethiopia needs to open the financial sector to foreign competition to strengthen innovation, financial intermediation, and domestic resource mobilization. Reforms are needed of regulations on the use of foreign exchange, restrictions on external loan repayments and suppliers of foreign partners' credits, and requirements for clearance certificates to obtain import permits.

Efficient public expenditure management is critical to ensuring that public spending facilitates inclusive growth. Much of Ethiopia's recent economic growth has been driven by infrastructure investments. To facilitate inclusive growth, efficient public investment management and coordination are needed. Low rankings on governance indicators—such as regulatory quality, management of corruption, and state enterprise efficiency—call for a focus on improving public expenditure management. Though Ethiopia has entrenched fiscal decentralization with a structured formula for allocating subsidies, reforms are required to increase accountability, reduce corruption, build human capacity, and enhance public procurement. Capacity needs to be built for public investments, project management, and coordination of public-private investments. Mitigating economic and political fragility will enhance peace and stability and raise long-term returns on public investments.

5.1.2 Expediting Investments in Enablers of Structural Transformation

Investments in growth enablers such as human capital, infrastructure, and institutions would ease structural imbalances. Given its population and industrial potential, Ethiopia is on an unsustainable, premature transformation path in which services have grown faster than manufacturing. Services have not generated as many good, wage-paying jobs as would have been expected from growth in manufacturing. Structural transformation will benefit from ongoing infrastructure investments and development of integrated agro-industrial parks, as well as from reforms to improve the business environment and strengthen skills. Efforts are also needed to expand the quality and reach of basic services and fill infrastructure gaps.

Human capital

Human capital should be strengthened by expanding technical and vocational education for needed skills. Those skills include entrepreneurship and service provision as well as time management and leadership. Improving the quality and relevance of technical and vocational education and training and of higher education is crucial to expanding the skills required by a middle-income country. More investment in demand-driven training institutions and qualified teachers is key to improving learning and acquiring skills that support innovation hubs. Training institutions should work with the private sector and other employers to address the country's skills mismatch by offering tailored training and arranging internships. Human capital development and skills acquisition will help Ethiopia reap the demographic dividend of its large, young, and growing population. Inclusive human capital development requires sustained pro-poor spending for equitable access to basic services. Efforts to build on the existing job creation agenda are needed to strengthen the enabling environment for business and provide innovative financing to young entrepreneurs. Gender mainstreaming should be pursued at all levels so that gendered perspectives are incorporated into all aspects of development interventions.

Infrastructure gaps

Despite enormous progress over the past 15 years, infrastructure gaps and quality issues remain. Overplaying infrastructure risks crowding out private investment—leaving little room for organic growth—and fueling inflation. Infrastructure spending translates into extensive rather than intensive growth, as shown by negative total factor productivity growth

in the 2010s. Further investments in energy generation and distribution are needed to increase access and reduce power cuts, which severely constrain private sector development. Increased electricity generation and exports will raise foreign currency earnings and support Ethiopia's green economic growth strategy. The country can also leverage its large energy potential to transform the economy by increasing generation, transmission, and connections. Rolling out the national electrification program is a priority because of the central role electricity plays in promoting growth and economic transformation. Macroeconomic reforms to resolve foreign currency constraints are urgently needed to facilitate public-private partnerships and independent power producers in energy. Some financing constraints could be eased by reforming restrictive financial sector regulations and promoting partnerships with multilateral development banks—such as the African Development Bank and World Bank--to offer risk guarantees, equity investments, and swaps.

During 2018-21 the energy sector raised tariffs to generate revenue. Tariff revision should continue beyond 2021 to take the depreciation of the Ethiopian birr against the U.S. dollar. But such steps should take into account energy affordability. The Council of Ministers is required to approve recommendations for tariff adjustments. But due to the technical nature of the revisions, the regulator could be delegated the authority revise the tariffs within certain bands for the long-term financial health of the sector and investor confidence. Generation, transmission, and distribution assets should be upgrade and the network expanded to unserved areas to improve service quality and reach. Innovative financing approaches—including public-private partnerships and outsourcing of operations and maintenance—should be explored to expand opportunities for private financing and expertise. The government could prioritize projects that promote regional power system integration including operationalization of the East African regional power pool. The Ethiopian Energy Authority, Ethiopian Electric Power Corporation, and Ethiopian Electric Utility require institutional and capacity improvements to ensure power delivery of expected results and quality. The benefits of separating generation and transmission mandates need to be weighed against the costs. Doing so could improve service delivery and prepare the sector for a competitive bulk power market and facilitate stronger private participation. These efforts require the support of development partners, including the African Development Bank.

Institutional Efficiency, Equity, and Coordination

Institutional capacity strengthening and coordination are needed to make public services more efficient. To improve accountability and control corruption, capacity needs to be strengthened to enforce laws. Particularly crucial is the capacity of institutions to examine violations and prosecute them independently. Ethiopia's sparse rural population and remaining infrastructure gaps constrain access to justice in real and economic terms. Increased funding is needed to make the justice system more accessible and responsive to the needs of poor people. Efficient institutions and improved national capacity for systematic gender mainstreaming are needed to support women entrepreneurs. Measures to improve gender equality could build on Ethiopia's experience with enhancing gender mainstreaming in project entities. Efforts to enhance women's entrepreneurial ability could be supported by extending innovative lending products that use nontraditional, nonasset-based collateral so that women can access credit and business development advice. Ethiopia also needs to build on the land ownership certification process to identify and address constraints that impede women farmers from fully benefiting from extension services.

5.1.3 Boosting Agricultural Production and Productivity

Better technology development and use in Ethiopian agriculture would generate major productivity gains. Given the small size of most landholdings and limited commercial farming, agriculture commercialization requires improved farming methods, inputs, coordination, and organization. Strengthening agriculture and food security through integrated value chains would improve the livelihoods of rural populations. Though significant progress has been made on the use of modern inputs (such as fertilizers and improved seeds), there is potential to expand agricultural productivity by adopting improved technologies and managing declining soil fertility.

Supply-side constraints should be addressed—such as institutional restrictions, poor infrastructure, and quality

logistics that limit wider application of modern inputs, particularly for remote farmers. Transportation challenges delay the arrival and limit the distribution of inputs. They also drive up transaction costs. Both issues ultimately lead to high input costs and low farmgate prices for farmers. The average Ethiopian farmer is 31 kilometers from a main road. Liberalization and better regulation of input markets are needed to create a competitive environment for the private sector and attract new players in the fertilizer and seed industries. In the immediate future, development partners should support the government to ensure that COVID-19 does not disrupt imports of fertilizers and other inputs. Private participation in seed multiplication, fertilizer manufacture, and input distribution would increase availability and lower costs.

Rural telecommunications and market links should be promoted throughout the supply chain. Better access to markets and information, as well as improved coordination and organization, are needed to take advantage of marketable surpluses from farm production. Increased investment in rural information and communications technology would help connect remote actors in the supply chain with accurate price information and facilitate their integration with regional markets. Allowing private participation in warehouse operations or opening them to cooperative unions would improve postharvest management.

Supporting the completion and operations of integrated agro-industrial parks would improve value chains. Focus is needed on the availability of power and the quality of transportation connections. Establishing viable agroprocessing businesses in rural areas is essential for creating jobs and enhancing demand for farm output. The government has identified integrated agro-industrial parks in 17 agricultural processing zones, and three of four pilot sites are operational. Distributing such parks across Ethiopia would address spatial disparities in investment, though it is unlikely to lead to the most efficient outcome unless accompanied by job creation and improved welfare. The government should focus such developments in areas with the greatest potential for forward and backward links in the supply chain, informed by rigorous analysis of existing resources and dialogue with the private sector. Development of integrated agro-industrial parks in more remote areas could be considered in the long term, once the necessary infrastructure is built and demand for value addition is established. That would address regional disparities in infrastructure and access to services. Capacity building and alignment of the roles of entities responsible for industrial parks are needed.

5.1.4 Increasing the Private Sector's Role in the Economy

Ethiopia needs to expand the role of the private sector to improve competitiveness and innovation. Reforms should promote private participation in all stages of the value chain, institutional support, and security of people and goods. Deepening financial reforms—including by establishing capital markets—would increase access to long-term financing. Ongoing reforms and liberalization efforts should be accelerated to create space for private competition, make public services more efficient, and reduce public spending. A coordinated approach between public and private players is needed. Several reforms are being undertaken, but more are required through conducive regulatory frameworks to increase transparency and reduce informal sector growth.

5.1.5 Scaling up Industrialization and Manufacturing

The government should ease economic constraints to industrialization and manufacturing growth including foreign exchange scarcity, trade facilitation, infrastructure development, and access to energy to expand manufacturing. For manufacturing and agroprocessing to thrive, a dynamic services sector is needed, including access to finance, electricity, and water. Lack of quality services impedes the emergence of competitive manufacturing, which matters for the quality and value addition of goods. The availability of skilled labor attracts foreign investment in Ethiopia. Technological development has been identified as an area that could lead to major leaps in manufacturing—specifically, by making production more efficient. Expanded exploration and exploitation of mineral resources would provide inputs and competitive advantage for industry. This requires addressing the quality and reach of infrastructure, facilitating links between manufacturing and mining, and easing legal, institutional, and technical barriers for large miners to manage relationships with local communities.

Faster policy reforms are key to the success of Ethiopia's industrialization drive. Reforms that mitigate constraints on access to finance, electricity, and land are needed to improve the investment climate. Limits on loans to micro, small, and medium-size enterprises—which are capped at 20 percent of their capital for banks and 5 percent for microfinance institutions—should be lifted to eliminate unnecessary constraints to industrial development. Establishing a collateral registry could help cut the costs of collateral that firms have to provide. Simplifying the tax system for micro, small, and medium-size enterprises and improving tax administration would reduce transaction costs for firms. Reforms to customs procedures and trade logistics and regulations would increase efficiency and trade. The development of industrial parks should follow international standards. And industry-tailored training institutions should be established and the curriculums of technical and vocational institutions reviewed, with private participation.

Transport should be strengthened to improve production and consumption, connectivity and accessibility, service quality, institutional capacity, regional integration and competitiveness, and financial, social, and environmental sustainability. Doing so would foster regional connectivity, increase aggregate production, consumption, and distribution of goods and services, lower handling costs, and optimize the capacity of transport vehicles. Routes should be established between agricultural production and major market centers to increase efficiencies and lower costs. A multimodal network of corridors and distribution nodes would allow users to choose optimal modes and routes. Government investments in science and technology and partner support to remove distortions in product and input markets and encourage firm-to-firm spillovers—including policies on land use and transport—are needed to make resource allocation more efficient, attract foreign direct investment, connect firms to export markets, and promote innovation.

5.1.6 Advancing Trade Diversification and Regional Integration

Ethiopia needs to do more to expand trade and diversify its exports. Trade suffers from low productivity and a weak business environment, underscored by limited access to finance, unreliable power, and reliance on imported intermediate inputs. Protectionist measures and many nontariff barriers—such as regulatory provisions or quotas—restrict capacities to trade, diversify, and expand. To increase efficiency and reduce the time and cost of moving exports and imports, the quality of roads and railway links to the seaports of Asmara and Djibouti should be improved and logistics management liberalized. These moves are particularly important for micro, small, and medium-size enterprises. The AfCFTA agreement offers new trade opportunities to Ethiopia, especially such firm. To benefit from the agreement, Ethiopia needs to address the prevalence of nontariff measures, assess border clearance processes, create secure and predictable market access to exports, and acquire internationally compatible electronic systems to enable updating of information and services linked to the electronic Single Window Project.

In January 2020 Ethiopia resumed WTO accession negotiations, which are expected to expand trade and improve quality standards. As part of these efforts, Ethiopia is working to revise its trade regime to conform with WTO rules, in consultation with an advisory council comprising members of the private sector, academia, and civil society. Negotiations are still underway, including preparation of key documents (the revised Legislative Action Plan and Officer on Goods). WTO negotiations require significant support because Ethiopia's trade organizations could accelerate the process, signaling a commitment to a transparent, predictable trade regime to attract investments. An intergovernmental coordination structure with relevant technical working groups is needed to improve efficiency and information dissemination. This will be complemented by measures to ease trading across borders, outlined in the Office of the Prime Minister's Doing Business Initiative. These measures include eliminating four documents required for import and export, physical inspections of some goods by reassessing the risk associated with their trade, implementing e-certification of origin, and piloting the electronic single window.

5.1.7 Harnessing the Potential of Tourism and Urbanization

The Ten-Year Development Plan, 2021-30 emphasizes the need to harness tourism for foreign exchange earnings and job creation. To do so, investments in enablers of the

sector are critical. Quality roads, communications, and energy systems are essential to good tourism performance. As such, sustained increases in investments will improve the quality of infrastructure. Efficient institutions will also play an important role in improving the quality of tourism services. Support institutions should expand marketing and branding activities and strengthen links between major airlines and tour companies. Further, investing in skills development would enhance the quality of services and improve tourism revenue. Careful physical and development planning for the rapidly growing urban population will benefit Ethiopia through the advantages of agglomeration and cheap labor for industrial development. Appropriate urban planning and land governance are key to ensuring the availability of essential services Capacity should be built for urban development to address gaps in planning and coordination of services.

Annex 1: Ethiopia's Ten-Year Development Plan, 2021-2030: A Pathway to Prosperity

I. Vision:

Ethiopia's Ten-Year Development Plan, (TYDP 2021-2030) was launched on 28th January 2021. The plan's vision is to make Ethiopia an "African Beacon of Prosperity" by creating the necessary and sufficient conditions for increased and quality investments by both the public and private sectors. The Ten-Year Plan is envisaged to provide the overarching longer-term plan to underpin the medium-term sector plans for growth and improved efficiency in the delivery of services. Prosperity is defined in terms of happiness, improvement in standard of living and quality of life, and the level of complete satisfaction created by the overall capability we build through economic gain, human and social development by harnessing tangible and intangible wealth, including social capital and natural resource wealth. High per capita income through rapid economic growth is an important source of prosperity, but the only source and measure of prosperity.

The TYDP 2021-2030 is people-centred and underscores issues of the micro, meso and macro stability and development with regional coordination at the heart of everything intervention to make it a reality. The plan is forward looking, with development aspirations to be realized for the people, beyond a single regime. The TYDP 2021-2030 builds on the previous five-year development plans (the Growth and Transformation Plans I and II) as well as the regional and global development frameworks including the Africa's Agenda 2063 and the Sustainable Development Goals.

II. The TYDP 2021-2030 has four expected outcomes:

1. Improved income levels and wealth accumulation for every citizen to be able to satisfy their basic needs and aspirations.
2. Improved equity in access to basic economic and social services such as food, clean water, shelter, health, education, and other basic services for every citizen regardless of economic status.
3. Create an enabling and just environment for citizens to utilize their potential and resources for better quality of life.
4. Improved social dignity, equality, and freedom where all citizens can freely participate in every social, economic and political affairs.

III. Objectives

1. Building a prosperous country by creating a pragmatic market-based economic system and enhance the role and participation of the private sectors.
2. Maintaining macroeconomic stability, ensuring rapid and sustainable economic growth, and creating decent jobs.
3. Ensuring structural economic transformation by promoting overall productivity, and competitiveness.
4. Creating an enabling environment where every citizen would become the owners and beneficiaries of the development endeavour by ensuring the quality and accessibility of basic social services and the provision of infrastructure.
5. Ensuring competent, independent, and quality civil service system by building the capacity of the government and establishing good governance.
6. Building strong and inclusive institutions that would ensure peaceful society, access to justice and upholding the rule of law and human rights.

IV. The plan is founded on ten strategic pillars

The first and key point of emphasis is the quality economic growth and shared prosperity. Economic growth is projected to remain at an average of about 10 percent a year for period to 2030. Structural transformation is expected to proceed steadily with the shares of Agriculture, industry and services reaching 22 percent, 35.5 percent and 42.5 percent, respectively by 2030 from the current 32.5 percent, 27.5 percent and 40 percent.

The others are 2. Economic productivity and competitiveness; 3. Technological capability and digital economy; 4. Sustainable development financing; 5. Private sector-led economic growth; 6. Resilient green economy; 7. Institutional transformation; 8. Gender and social inclusion; 9. Access to justice and efficient civil services, and 10. Regional peace building and economic integration.

V. The key areas of focus include:

Multi-sectoral sources of growth and job opportunities; Harnessing the demographic dividend (including education, health and creation of job opportunities); Peace, justice and inclusive institutions; Sustainable urban development; Sustainable and inclusive financial sector; and Quality and efficient infrastructure projects.

VI. Implementation approach:

A whole-of-government approach is planned, with strong coordination between the Federal and the Regional governments as well as all responsible agencies and institutions. Capacity building will be a critical element of the implementation strategy. There will be a departure from orthodoxy economic policy making to a more dynamic and inclusive approach. The areas to enable and guide implementation, include:

1. Human resources and skills development. Emphasis will be placed on strengthening the quality of education and training at all levels of the education system in order to deliver the skills required by both the public and private sectors to take Ethiopia to the next level of development. Skills diversification and matching supply with demand will be underscored as well developing an entrepreneurial and innovative mind set, especially among the youth.

2. Vertical and spatial considerations will be emphasised in the development of national regional development frameworks to underscore equitable growth.

Three-year implementation plans will be development and the plan, strategies and policies will be evaluated every three years. Regional development frameworks will be developed, and existing legal frameworks strengthened to promote accountability for action and resources.

VII. Progress Monitoring:

Monitoring will be done through quarterly and annual reports prepared by sectors and mid-term reviews to be undertaken every three years, in 2023 and 2026. Progress tracking instruments including Key Result Areas and Key Performance Indicators have been developed, master reporting guideline and a monitoring and evaluation matrix prepared.

Source: FDRE 2021.

Annex 2: Ethiopia's Climate Change and Green Growth Strategy

Ethiopia's Climate Resilient Green Economy Strategy of 2011 provides the national blueprint framework to address climate change adaptation and mitigation objectives and build resilient economic development. The strategy covers the key sectors of the economy including agriculture, forestry, transport, electric power, industry and buildings. Designing green cities is at the heart of the strategy in the area of urban development.

Ethiopia aims to achieve middle-income status by 2025 while developing a green economy. It is therefore noted that following the conventional development path would, among other adverse effects, result in a sharp increase in GHG emissions and unsustainable use of natural resources.

Support of development partners is needed to transform the Green Growth strategy into action. The vision of the strategy is to: Achieve middle-income status by 2025 in a climate-resilient green economy. Building on its positive recent development record, Ethiopia intends to reach middle-income status before 2025.

As set forth in the second Growth and Transformation Plan (GTP-II), reaching this goal requires boosting agricultural productivity, strengthening the industrial base, and fostering export growth. As a responsible member of the world, Ethiopia is also aware of the important role that developing countries play in fighting climate change and has consequently taken on a constructive role in international climate negotiations. Ethiopia's ambition to become a "green economy front-runner" is an expression of its potential for and belief in a sustainable model of growth. The challenge is to achieve economic development goals in a sustainable way. If Ethiopia were to pursue a conventional economic development path to achieve its ambitious targets, the resulting negative environmental impacts would follow the patterns observed elsewhere around the globe.

Under current practices, greenhouse gas (GHG) emissions would more than double from 150 Mt CO2e in 2010 to 400 Mt CO2e in 2030. Its development path could also face resource constraints: for example, it could reach the carrying capacity for cattle. Furthermore, it could lock its economy into outdated technologies. A conventional development path could also be financially challenging. For example, a significant share of GDP might need to be spent on fuel imports, putting pressure on foreign currency reserves.

Four initiatives to fast-track the implementation are included as part of an action plan to create a green economy. These include exploiting the vast hydropower potential; large-scale promotion of advanced rural cooking technologies; efficiency improvements to the livestock value chain; and Reducing Emissions from Deforestation and Forest Degradation (REDD). These initiatives have the best chances of promoting growth immediately, capturing large abatement potentials, and attracting climate finance for their implementation.

Source: FDRE 2011.

Annex 3: Ethiopia Fragility and Resilience Analysis

1. Introduction

This analysis provides an overview of recent developments, with a focus on political, economic, social, environmental/climate and regional dimensions impacting peace, stability and prosperity trajectories. Ethiopia is not classified as a Transition State by the Bank Group. However, the country is affected by persistent pockets of fragility, including external shocks, that could undermine its development efforts.

Ethiopia is the second most populous country in Africa, with about 115 million people in 2021, and the 10th largest land area of more than 1.1 million square km. It also has a great geographical and climatic diversity thanks to its mountainous relief, a rich cultural and religious history (Orthodox since the 4th Century, Muslim since the 7th Century), as well as an ethnic and linguistic diversity recognized in its constitution. Ethiopia plays important military and diplomatic roles given its strategic position in the Horn of Africa. The capital, Addis Ababa, hosts the headquarters of the African Union and has a growing number of regional economic relationships. Ethiopia is a member of the Common Market for Eastern and Southern Africa (COMESA), Inter-Governmental Authority on Development (IGAD), and the East African Power Pool.

Despite its large socio-economic potential, Ethiopia faces many challenges. Reforms and skills development are needed for Ethiopia to reap its demographic dividend and avoid dissatisfaction among its youthful population due to lack of decent jobs and opportunities. Growth over the recent past has not generated enough jobs, even before the COVID-19 pandemic, further undermining efforts to reduce poverty and inequality. The need to reinforce social cohesion and access to basic services through efficient health, education, functioning labor markets and social protection as well as energy, transport and agriculture is paramount. At the same time, the country faces a major political transition, with growing demands for increased political participation and freedom of expression mainly by the youthful population. Ethiopia is facing heightened internal pressures, exacerbated by the conflict in Tigray region, occasional spikes in violence in some regions and some ongoing disputes with neighbouring countries.

2. Context

Ethiopia operates a Federal system of governance enshrined in the Constitution of 1995, which grants unlimited political autonomy to different ethnic groups. “Every Nation, Nationality and People in Ethiopia has an unconditional right to self-determination, including the right to secession.” However, this provision is interpreted by some political groups to mean full autonomy, resulting in demands for separation from the Federation. Prime Minister Ahmed Abiy who came to office in April 2018 has since introduced wide ranging macro-economic, sectoral and political reforms, underscored in the Home-Grown Economic Reform Program (2019-2021). The reforms aim to expand economic and political inclusiveness by addressing macroeconomic imbalances and structural bottlenecks to unlock the potential of the private sector and to create jobs. Some 20,000 political prisoners were released in 2018, exiled political actors allowed to return and the electoral, media and civil society laws are being amended to increase participation. However, these reforms are interpreted differently by different political entities who use their dissatisfaction to foment ethnic conflicts and confrontation with the Federal Government. Continued dialogue, focusing on pea ceful resolution of differences is needed among all stakeholders.

Over the last two decades, Ethiopia has recorded robust economic progress despite the local and global shocks such as the COVID-19 pandemic, climate change issues, locust invasion and security issues. However, challenges have emerged in the recent past, with the public sector-led growth model reaching its limit. Ethiopia remains a low-income country Ethiopia’s demographic pressure remains strong. The overall outlook is that the pressure on job creation, service provision and natural capital will rise sharply rather

than diminish in the future. Demographic projections indicate that 2.5-3 million young Ethiopians enter the labor force every year who are not being fully absorbed into formal employment.[10] There are mounting macroeconomic imbalances, structural and sectoral constraints, including high rates of inflation, rising public debt, reduced FDI inflows, foreign currency shortages and weak market structure. Sporadic inter-ethnic violence, and contestations between some regional states like Tigray and the Federal Government have exacerbated these challenges. Poverty rates and rising inequality, youth unemployment as well as ethno-political tensions have been simmering since 2015.

Tensions between the Tigrayan People's Liberation Forces (TPLF) and the Federal government started when Prime Minister Abiy came to office in 2018. The TPLF is said to have interpreted the reforms as a threat to its economic and political dominance under the Ethiopian People's Revolutionary Democratic Front (EPRDF), the coalition that ruled Ethiopia for 28 years from 1991. In 2019, Prime Minister Abiy created the Prosperity Party, to succeed the EPRDF, with membership open to all regional parties in an effort to end exclusion. However, the TPLF refused to join the Prosperity Party. In September 2020, the Tigray region held its own election against the Government's postponement of all elections due to the COVID-19 pandemic. The TPLF was also accused of fomenting rebellion in different parts of the country. Early November 2020, the TPLF raided a Federal Military command post in Tigray region killing Federal Military personnel, and the Federal government responded with what it called a Law Enforcement Operation (LEO) on 4th November, which officially ended on 28th November 2020. However, the conflict continued with clashes between the TPLF and government forces in Tigray. There are reports of ethnically motivated violence (intercommunal and across states, for example, Afar, Amhara, Oromia and Tigray). Commitment by the involved parties to prevent ethnic profiling and discrimination is important.

The current conflict has stretched the humanitarian situation with more than 7 million people requiring food aid and over 400,000 living in near-starvation conditions. Restricted access has affected humanitarian assistance and aid delivery. However, since February 2021, access has improved. It is reported that at least two million people (about 40 percent of the target beneficiaries) have received humanitarian assistance. The Government allocated block grants, regional budget and additional humanitarian response budget equivalent to US$801 million to respond to the crisis. Led by WFP, food assistance is being provided to people in need and humanitarian partners are scaling-up responses to gender-based violence, including identification and provision of support to survivors. However, there is a funding gap of US$1.3 billion to cover the humanitarian requirements. The Tigray region, with a population of about 7 million people, has one of the highest levels of poverty estimated at 27 percent in 2016, compared to the national average of 23.5 percent. The ongoing conflict and displacement of people is exacerbating these challenges.

Developments in October-November have underscored the fluidity and dynamics in terms of insecurity, conflict and violence in some parts of the country. These have led to repeated African Union and United Nations pleas for dialogue for peaceful conflict resolution (at community, national and international levels). This is crucial as an escalation and protracted instability would undermine the development trajectory of Ethiopia, which would be detrimental to the aspired poverty reduction and growth ambitions.

3. Overview of Ethiopia's resilience and fragility assessment.

The root causes of instability in Ethiopia are complex, with historical legacies of conflicts, grievances and general underdevelopment being exacerbated by real or perceived marginalization. The Country Resilience and Fragility Assessment (CRFA) offers data-based insights on the capacities and pressures across seven dimensions: Inclusive Politics, Security, Justice, Economic and Social Inclusiveness, Social Cohesion, Regional Spill-Over Effects and Climate/Environmental Impacts.

[10] United Nations cooperation framework with the Federal Democratic Republic of Ethiopia for the period 2020 -2025.

Recent political reforms underscore opening the political space, inclusion of women and youth. Ethiopia has ratified the United Nations Anticorruption Convention and the Federal Ethics and Anti-Corruption Commission (FEACC) is pursuing measures to combat corruption, including arrests and successful prosecution of some high-profile government officials and private sector operators. Whistle-blower legislation was passed and the FEACC is working closely with key stakeholders. Space for civil society engagement is slowly improving, with the revision or repeal of restrictive federal legislations such as the 2009 Charities and Societies Proclamation, and Broadcast and Media regulations. The revised Civil Society Organizations' (CSO) Proclamation (5th February 2019) aims to improve the environment for CSO engagement in the management of public affairs. A ministry of Peace was established in 2018 to promote dialogue for peaceful resolution of tensions. Improvements in the federal-state relations, reconciliation and de-escalation of tensions are needed.

Security. The government has made security and stability core priorities for Ethiopia and defense institutions have been strengthened. However, the policing institutions experience significant pressures in the face of increased criminality. Tensions unfortunately again rose recently within the country and with some of its neighbours. In spite of ongoing Government efforts to protect civilians, it needs to be scaled-up across the country, including clear instructions to all military and police forces (chains of command and cadres on the ground) to ensure protection of the unarmed, with reinforced accountability measures to quell violations. This will help legitimize efforts to enhance stability and security. Peaceful resolution of regional disagreements remains paramount.

Access to justice. Progress is being made to improve equitable access to justice and reduce impunity of senior officials. More needs to be done to strengthen both the effectiveness and the independence of judicial institutions. Access to justice for all, including due process, fair trials and rights to appeal remain core priorities in urban and rural settings. Efforts in the recent past to free detainees following peaceful protests or avoid detention of peaceful protesters showcase that there is some progress. Risks remain that some of the positive developments might be eroded. A strong, well capacitated, independent justice system will contribute to state legitimacy and enhance public trust.

Economic and social inclusiveness. Marginal progress has been made in comparison to the 2019 CRFA. Impressive growth and action-oriented political commitment over the past years have yielded some positive developments vis-à-vis poverty reduction. Never-the-less, such efforts have been constrained by rapid population growth, a lingering forced displacement crisis (about 1.7 million internally displaced persons and 700,000 refugees), droughts, conflict in some parts of the country and the COVID-19 pandemic. Collaboration with Development Partners (DPs) is strong and efforts to unlock the potential of the private sector are more important than ever, including an expansion of the export base along value chains with clear value addition in the country.

The most noticeable pressure under social cohesion relates to the rise of group identity-based polarization. Ethiopia is dealing with legacy challenges and cumulated grievances over the past decades, which cannot be resolved via quick fixes. Governmental efforts to strengthen the social fabric, advance the sense of belonging, respect for diversity and dialogue to foster peaceful co-existence and resolution of differences are commendable. These can be strengthened at community, state and at federal leadership levels. This needs to focus on avoiding real or perceived marginalization, enhancing mutual respect, equality and understanding to overcome legacy rivalries via win-win progress.

Ethiopia is among a few countries globally with a female Head of State. In addition, key positions such as the Federal Supreme Court President and National Electoral Board Chair are now held by women for the first time in the nation's history. Currently, women representation in the Federal Parliament is at 39 percent, up from 27 percent in 2010. The Women's Caucus, and the Women and Children's Affairs Standing Committee of the Federal Parliament monitor the implementation of gender equality policy objectives and gender mainstreaming in national plans and programs. Similarly, women representation in the federal judiciary (all tiers) is around 30 percent. A ministry of peace was established in 2018 to promote peaceful co-existence and conflict resolution. Conflict management and resolution mechanisms including inter-faith groups, civil society coalitions, and relevant ministries or agencies are organized and proactive.

Externalities and regional spillover effects, the rise of transnational crimes has increased pressure on this dimension by over 100 percent. Progress has been made in recent years with commitments to regional peace and conflict prevention and resolution through political dialogue. However, displacements of populations remain a major concern, as are long-term disputes in border regions/over water-resources, posing serious risks, if not dealt with in a well calibrated and balanced manner. Notable examples are Sudan border crisis and the Ethiopian-Egypt-Sudan crisis linked to the impacts of the Grand Ethiopian Renaissance Dam (GERD). A March 2021 UN report indicated that "tensions remain high in the conflict along the Sudan-Ethiopia border, with Sudanese and Ethiopian armed forces - including Amhara militias - and Eritrean forces deployed around the Barkhat settlement in Greater Fashaga". Mediation efforts are ongoing with the support from the AU and/or the UN, as peaceful resolution of these impasses will consolidate peace and security in the region and particularly maximize the developmental impact of the GERD.

4. Other challenges and opportunities

The conflict in the Tigray Region presents a roadblock to Ethiopia's economy which is already impacted by the COVID-19 pandemic. Ethiopia's Ministry of Trade and Industry estimates that the closure of factories and mining sites in Tigray since November 2020 was negatively affecting the Ethiopian economy. Lower-than-expected rainfall in late 2020 and early 2021 and deteriorating macroeconomic conditions have contributed to the high level of food insecurity that is projected to last through September 2021 (at least) in much of eastern and central Ethiopia. Integrated Food Security Phase Classification (IPC) level 3 is projected to be present in Tigray's Western Zone, Oromia's Borana Zone, and Sidama while IPC level 2 is projected to be present in parts of Amhara's East Gojam Zone. This could be most serious in some parts of Tigray which are in IPC level 4. Amhara, Tigray, Oromia and Sidama regions offer development opportunities both in terms of agriculture/livestock, agro-industry and jobs, but these could be undermined in case of continued or renewed insecurity. In particular, the continued security challenges in key regions in Ethiopia and pressures emanating from insecurity in neighbouring countries (Sudan, Eritrea, Somalia, and South Sudan) are of concern.

The Western Zone of the Tigray Region saw the highest level of violence during the LEO, accounting for over 50 percent of reported fatalities according to Armed Conflict Location & Event Data (ACLED). Reported levels of violence dropped very low after the conclusion of the LEO at the end of November 2020 but spiked sharply in May 2021 due to a clash between the Ethiopia National Defence Forces (ENDF) and TPLF/Tigray Defence Force (TDF) forces in which over 300 were reported killed. The recent friction between Ethiopia and Sudan along their border at the Benishangul-Gumuz Region present potential additional risks in the current context.

Unlike Tigray region, violence remained low in Amhara region in 2020. However, that situation changed in early 2021, with the flow of TPLF forces into the region and an increased number of fatalities. The violence has thus far been concentrated in Amhara's North Shewa (Amhara) and Oromia Zones. However, as ENDF forces are likely to remain stretched by continuing violence in not only Tigray but also Benishangul-Gumuz and Oromia Regions in addition to Amhara, there is a likelihood that violence will persist, with a risk that it will increase in severity or spread in geographic scope.

Violence in both eastern Amhara and western Oromia is attributed to the Oromo Liberation Army (OLA), a splinter group from the OLF. The OLA has denied responsibility for many of these attacks. Violence increased sharply in Oromia in 2020, with more than three times the reported number of fatalities as in 2019, most frequently associated with the OLA. In early May, the Ethiopian government declared the OLA, along with the TPLF, as terrorist organizations, a move which was unanimously endorsed by Members of the Federal Parliament. Sidama Region was formed on 18th June 2020 when it seceded from the SNNP Region, following a majority vote in a 2019 referendum. Additional ethnic groups have been agitating for similar secessions, and that agitation has the potential to further increase violence, which could spill-over into either Borana Zone or Sidama Region.

5. Regional dimension of the crisis

The Tigray crisis is occurring in a complex geopolitical environment where countries in the Horn of Africa and beyond are vying for greater influence and control in matters

of security and power.[11] Ethiopia's position as a major security provider and negotiator/facilitator in peace missions, for instance, assisting in the stabilization of South Sudan and Somalia, may be compromised if the crisis in Tigray continues. The current electoral turmoil in Somalia is another pitfall that could jeopardize the precarious regional peace should the conflicts in Ethiopia persist. The alliance between Eritrea and Ethiopia to quell the conflict in Tigray could have implications for regional stability. It is believed that Eritrea's direct involvement in the conflict was in pursuit of its national security interests, with fears that the TPLF could attack its border territories. It also sought to prevent the TPLF from firing missiles towards Asmara, as was the case in November 2020.

6. Sources of resilience and prospects for an inclusive growth

Ethiopia's performance has been remarkable in terms of its rapidly growing economy and declining poverty rates over the past years. But it also faces serious national development challenges. As one of Africa's largest and most populous countries, Ethiopia has significant infrastructure needs. Continued reliance on rain-fed agriculture in the face of increasing variable rainfall creates persistent food security problems. Ethiopia has long been associated with images of conflict, famine and extreme poverty. However, since 2000, while remaining in the category of least developed countries, it has been one of the most dynamic economies in Africa. The Government promoting structural transformation, as outlined in the TYDP, 2021-2030 and previous five-year plans. By facilitating the transition of workers from low to high-productivity activities, including agricultural processing and light manufacturing, Ethiopia is laying the foundation for its goal of becoming a middle-income country by 2025.

The is upgrading infrastructure and improving education, technical training (construction of 600 technical colleges for one million students) and university training (construction of thirty universities with a capacity of 400,000 students, and modification of the curricula to include scientific subjects).

This mobilization and elimination of distortions inherited from previous regimes are the two main ingredients to accelerate the economy, which has led to a sharp reduction in poverty over the past 20 years. Agriculture is the largest sector of the economy, employing four-fifths of the workforce and 70 percent of export earnings. Rural areas have been a major beneficiary of public sector investment, much of which has been spent on infrastructure to enable farmers to access inputs and markets. The government has designed incentives to position the country as an industrial hub, including tax exemptions on corporate income tax for 6 years for professionals in industry and agribusiness, to exemptions from customs duties on the import of capital needed for projects in all sectors.

The ongoing conflict has implications for Bank-financed projects in the region because of the difficulty of movement and communication with implementing units on the ground. Contracts for Bank projects were stopped. The Bank is working closely with the Government and DPs to minimize disruptions to operations and to provide support to communities in conflict areas. The bank will also continue its efforts to contribute to enhanced inclusiveness and strengthened social cohesion via its policy dialogues and operations. The Bank will sustain active engagement within the DPG which is instrumental in engaging the Government on plans for humanitarian support and post-conflict recovery. The Bank is co-Chair of the DPG for the period July 2021 – June 2022, together with the Ministry of Finance and the Embassy of Germany. This has strengthened the Bank's position to directly engage with Government on strategic issues impacting the timely and effective delivery of its projects.

Source: AfDB internal analysis.

[11] Geneva Centre for Security Sector Governance. https://issat.dcaf.ch/Learn/Resource-Library2/Policy-and-Research-Papers/The-Foreign-Military-Presence-in-the-Horn-of-Africa-region.

Annex 4: Monitoring and Evaluation of Development Outcomes

I. Status of the National Statistics System

Ethiopia's National Statistics System (NSS) is centralized and managed by the Central Statistical Agency (CSA). The CSA, established through Proclamation #442/2005, is mandated to coordinate, monitor, and supervise data gathering and dissemination at the Federal level as well provide advisory services on statistical activities to government agencies and private organizations. The CSA provides quality statistical data that are in line with international standards, sets the policy direction, regulations and standards for producing official statistics. The NSS produces statistics to monitor progress on the national development priorities, the 2030 Agenda for Sustainable Development and Agenda 2063. It also contributes to regional integration data needs including the Harmonized Consumer Price Index (HCPI) and the International Comparison Program (ICP).

The benefits of Monitoring and Evaluation (M&E) have been highlighted for assessing the effectiveness of implementation and impact of development plans and project results. An efficient M&E system ensures greater accountability and effectiveness of the Bank's investments towards achieving national outcomes and the High 5's priorities. The Government underscores the importance of quality statistics in monitoring the implementation of its development plans. Therefore, a robust M&E system is important to help gauge performance and promote efficiency in policy making process. As such, all development projects should be designed with quantifiable performance indicators for which assessment can be done through the project implementation cycles. This chapter undertakes an assessment of the state of M&E in Ethiopia and the extent to which it has played a role in guiding policy implementation.

II. Challenges in the National Statistics System

Ethiopia's National Statistics System faces several constraints that impede its effectiveness. These constraints are pronounced at the national and regional levels, thus affecting policy i mplementation. For example, the NSS has been forced to postpone the population and housing census since 2017 due to security concerns and shocks such as the COVID-19 pandemic. The second National Strategy for the Development of Statistics (2015/16-2019/20) is yet to be replaced. Shortages of human and financial resources impact statistical capacity, leading to gaps in statistical outputs.

III Bank Activities for Building Statistical Capacity

The Bank's statistical capacity building approach recognizes statistics as global public goods transcending national boundaries with national, regional, and global impacts. Interventions support continuous statistical capacity programs for managing development results. During 2016-2020 the Bank provided capacity building in M&E to Ethiopia's Development Planning Commission as well as technical assistance in the preparation of the Strategic Plan for Agriculture and Rural Statistics (SPARS-ETH). This supported the strengthening of the NSS, in line with the Strategy for the Harmonization of Statistics in Africa (SHaSA.2) that focuses on enhancing development of official statistics to measure progress against the Bank's High 5's, the SDGs and Agenda 2063. Ethiopia has also received support from other development partners, including the World Bank to enhance statistical capacities and infrastructure.

IV. Conclusion

The need to strengthen the capacity of the Central Statistics Agency to transform the NSS into a robust system capable of providing quality and timely data on a sustainable basis cannot be overemphasized. The Bank will support the preparation of the three-year implementation plans, with a focus strengthening the M&E components to accompany the TYDP, 2021-2030. This is important to identify the right results measurement framework, appropriate indicators and data collection to allow for adequate monitoring of the plan.

The Bank will support the design of a successor sector based NSDS to strengthen coordination and efficiency of the data ecosystem. Development partners, together with RECs need to sustain support to Ethiopia's NSS by including provisions for national statistical programs (such as population and housing census and household surveys) in their interventions.

Statistical advocacy at higher levels of decision-making is important to underscore its statistics and increase resource allocation for evidence generation.
Source: AfDB internal analysis.

Source: AfDB internal analysis.

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