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Report No: 19039

PERFORMANCE AUDIT REPORT

ETHIOPIA

STRUCTURAL ADJUSTMENT CREDIT
(Credit 2526-ET)

March 16, 1999

Operations Evaluation Department

Currency Equivalents

Currency Unit: Ethiopian Birr

Average Exchange Rate

	1992	*1993*	*1994*	*1995*	*1996*	*1997*
US$1.00=Birr	2.1	5.0	5.5	6.0	6.3	6.7

Weights and Measures

Metric System

Fiscal Year

July 8 – July 7

Abbreviations and Acronyms

CAS	Country Assistance Strategy
ERRP	Emergency Recovery and Reconstruction Program
GNP	Gross National Product
ICR	Implementation Completion Report
IDA	International Development Association
IMF	International Monetary Fund
MF	Ministry of Finance
OED	Operations Evaluation Department
PIU	Project Implementation Unit
PFP	Policy Framework Paper
SAF	Structural Adjustment Facility
SAR	Staff Appraisal Report
SIDA	Swedish International Development Agency
TGE	Transitional Government of Ethiopia

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The World Bank
Washington, D.C. 20433
U.S.A.

Office of the Director-General
Operations Evaluation

March 16, 1999

MEMORANDUM TO THE EXECUTIVE DIRECTORS AND THE PRESIDENT

SUBJECT: Performance Audit Report on Ethiopia – Structural Adjustment Credit (Credit 2526-ET)

Attached is the Performance Audit Report (PAR) for the Ethiopia Structural Adjustment Credit (Credit 2526-ET) for SDR 176.5 million (US$250 million equivalent), prepared by the Operations Evaluation Department. The Credit was approved in FY93, and closed in FY97, twenty-one months after the original closing date. Co-financing was provided by Switzerland, Sweden, and the Netherlands.

This Structural Adjustment Credit was designed to support the first phase of the Government's program of structural reform to transform the economy from a centrally planned economic system to a market economy. It also reinforced the measures outlined in the Policy Framework Paper (PFP) prepared jointly by the Government, the IMF and IDA. Specifically, the objectives of SAC-I were to support two groups of measures, including: (a) to aid in implementing a sound macroeconomic stabilization framework, and (b) to address initial constraints to increased participation by the private sector in employment creation. SAC-I also included studies intended to provide background information for the design of later phases of the reform program. At the same time, it provided financial support to assist the transition to higher levels of savings and investment, revenue collection, and an improved balance in the current account.

The Government was committed to the program, began to implement it before the project became effective and continued implementation after project closing. Consequently, the project fully achieved, and in some cases surpassed, its objectives. Program targets were met or exceeded in almost all areas, although implemented later than envisaged, due to the administrative difficulties of implementing the project under Ethiopia's difficult political and social transition. Measures to raise revenues and control expenditures resulted in improved fiscal performance; the budget deficit before grants decreased from 11 percent of GDP to 8 percent; and domestic bank financing of the deficit declined substantially. As a result, inflation fell from over 20 percent per annum in FY91-92 to an average of 6.3 percent in FY93-96. Success in encouraging private sector development is seen by a rise in the share of non-government investment in total investment from 17 percent to 60 percent. The economy began to recover: GDP grew by 7.8 percent per annum during FY93-96 compared to a 3.4 percent annual decline in FY91-92. In conjunction with these solid macroeconomic measures, a welfare monitoring system was instituted and a Social Rehabilitation Fund established.

The role of the Government in the economy was reduced. Prices of most commodities were decontrolled. Import tariffs were reduced and the tariff structure was rationalized. Import and export licenses were abolished. Export taxes, except for coffee, were eliminated and export subsidies were ended. A foreign exchange auction was put in place in 1992, and multiple exchange rates were unified in 1995. Initial steps were taken toward market determined interest rates. The monopoly power of the Agricultural Marketing Corporation was eliminated, and retail prices, except petroleum, were decontrolled. "One stop" investment offices were introduced; private banks and insurance companies were established; new land policies were adopted, a privatization agency was established and privatization got underway. A study for phased liberalization of the coffee sector was carried out and measures were taken to allow private sector activity in all stages of coffee processing, marketing, and export. Policies and directives for a reduction of the civil service were adopted

In spite of the extensive list of achievements under this Credit there is a substantial unfinished agenda to be carried out in order to complete the transition to a market economy. To date Ethiopia has only been successful in attracting a minimal amount of foreign investment, and the unfinished agenda is no doubt one of the causes for this. There is need for further liberalization of the foreign exchange regime, attention to the issue of land ownership, further improvements in the important coffee sector, privatization of the large number of factories, hotels and other services, and housing still in Government hands, and restructuring of the banking system. While SAC-I was fully successful in meeting the initial goals of the transition process, action to complete the transition has now slowed. The Government is studying many of these issues, although its schedule for action is unclear.

The Evaluation Memorandum rates the project outcome as highly satisfactory, institutional development impact as modest, sustainability as likely, and Bank performance as satisfactory. The PAR concurs with these ratings, however the project outcome was lowered to satisfactory, given the delays in implementing some of the key reforms sought.

The main lessons to be drawn from this project are that (a) strong Borrower commitment, coupled with early attention to institutional capabilities, can ensure that complex reform agendas in transition economies are achieved in a relatively short time frame and (b) key reform initiatives implemented prior to Board approval are essential for the credibility of a protracted, structural reform agenda.

Attachment

Contents

This report was prepared by Robert Nooter (Consultant), who audited the project in July 1998, under the supervision of Roger Robinson (Task Manager). Administrative assistance was provided by Barbara Yale and Brigitte Wittel.

Preface

1. This is a Performance Audit Report (PAR) on the Ethiopia Structural Adjustment Credit for an amount of SDR176.5 million (US$250 million equivalent at appraisal). The credit was approved in June 1993, and closed in September 1996.

2. The PAR is based on the Implementation Completion Report (ICR) prepared by the Africa Regional Office and issued in June 1997, the President's Report for the project, the legal documents, project files, related economic and sector work and discussions with Bank staff and Government officials. The PAR provides further insight into the extent of project achievements and the benefits that have occurred in the transition, macroeconomic stabilization and growth of the Ethiopian economy.

3. An OED mission visited Ethiopia in July 1998, and discussed the effectiveness of IDA's assistance with public sector officials, representatives of the business community and private sector commercial banks. Their kind cooperation and assistance in the preparation of this report is gratefully acknowledged.

4. The draft PAR was sent to the Borrower and the co-financiers and no comments were received.

Ratings and Responsibilities

Performance Ratings

	Structural Adjustment Credit (Credit 2526-ET)
Outcome	Satisfactory
Sustainability	Likely
Institutional Development	Modest
Borrower Performance	Satisfactory
Bank Performance	Satisfactory

Key Project Responsibilities

	Structural Adjustment Credit (Credit 2526-ET)		
	Task Manager	*Division Chief*	*Director*
Appraisal	Deepak Bhattasali	Michael Carter	Francis X. Colaco
Implementation	David Yuavlivker	Michael Carter	Francis X. Colaco
Completion	Hong Zhang	Roger Grawe	Oey Meesook

1. Background

1.1 Ethiopia is the second most populous country in Sub-Saharan Africa with more than 55 million people. With per capita GNP of US$110 in 1996, it also has the second lowest per capita income in the world. Ethiopia's considerable economic potential has remained largely unexploited because of political and economic problems prior to 1991. The Government that ruled Ethiopia for nearly two decades nationalized or dismantled most of the private sector and imposed a centrally planned economy. These policies, together with a drain on resources caused by a major war effort, left the Ethiopian economy in shambles. Following the long war, a coalition led by the Ethiopian People's Revolutionary Democratic Front assumed power in May 1991, and the Eritrean People's Liberation Front came to power in Eritrea. Following a National Conference on Peace and Democracy in July 1991, the Transitional Government of Ethiopia (TGE) was formed under a charter that required national elections to be held at the end of a transition period of approximately two and one-half years. The status of Eritrea was determined by an internationally supervised referendum on April 23-24, 1993. Voters overwhelmingly voted for an independent Eritrea, which was declared on May 24, 1993.

1.2 By mid-1991 when the TGE assumed power, much of the economic infrastructure had been destroyed or was in an advanced state of disrepair, and foreign exchange was virtually unavailable. As a result, factories and farms lacked raw materials and spare parts. Real output per capita had declined over the previous three years by more than 6 percent. By 1991, the gross investment rate had fallen to 9.2 percent of GDP, down from 15.8 percent three years earlier. Nearly 50 percent of the population was suffering from absolute poverty, with an estimated average per capita daily calorie intake of 1,750, only 80 percent of the minimum level determined to be necessary for a healthy life. Earnings from exports had declined to US$276 million in 1991, compared to US$459 million in 1980. Debt servicing stood at 79 percent of exports of goods and non-factor services in mid-1991, and debt servicing arrears had reached US$408 million. In addition, as a result of the effects of earlier fiscal imbalances and acute shortages during the last months of the civil war, the annual rate of inflation had risen to 21 percent. The budget deficit for the fiscal year 1990/91 was 11.2 percent of GDP, domestic bank financing of the deficit reached 9.6 percent of GDP, and gross official reserves had fallen to about one week's worth of imports. (See Table 1, Annex B, page 30 for a full range of economic indicators prior to this Credit).

1.3 In August 1991, the TGE began an extensive debate on economic policy. In November 1991, the Government adopted an economic policy paper called the Transitional Period Charter, intended to form the basis for the TGE's economic policies during the transition period. The policy paper emphasized the need to revitalize the economy and create a conducive environment for development. To attain these objectives, the TGE aimed to limit the role of government to selected economic services, encourage private investment and promote significantly greater participation of the private sector in the economy, mobilize external resources, and pursue appropriate macroeconomic and sectoral polices. Some fundamental issues that were perceived likely to be controversial, such as land ownership, private ownership of financial institutions, and price decontrol of a few selected services and goods, were set aside to be addressed through a national referendum after a new constitution was adopted and a national assembly elected. The Transitional Period Charter also set out the objectives of the TGE on the social front, which included rehabilitation of areas and peoples most severely affected by the war and of populations uprooted as a result of the previous Government's villagization and resettlement programs, reconstruction of infrastructure, and support for previously neglected regions. Thus, before the

Government undertook discussions with the IMF and World Bank on the first Policy Framework Paper (PFP), it had already developed clear ideas of what it wanted to accomplish in the economic and social spheres.

1.4 During late 1991 and early 1992, the World Bank coordinated a consortium of donors to support the TGE's efforts to reconstruct its war-torn infrastructure, reactivate economic production, provide essential medicines, and launch a pilot social fund to provide support for community-led efforts to rebuild destroyed local facilities. The multi-donor effort, called the Emergency Recovery and Reconstruction Program (ERRP), mobilized about US$600 million in total external support for Ethiopia's immediate needs. This included a new IDA commitment of US$150 million, approved by the IDA Board on March 31, 1992, and US$80.7 million of restructured assistance from the existing World Bank portfolio. The ERRP included repair and replacement of essential economic assets and infrastructure, and the provision of key inputs to produce higher growth from existing facilities. Inputs included seeds, fertilizers, spare parts, construction materials, funding and equipment for the rehabilitation of social infrastructure such as health and education, and transportation including trucks and buses, ports, railways, and civil aviation. There was also a special focus on the rehabilitation of transportation and road networks. Conditionality was generally limited to actions deemed necessary to facilitate the implementation of the Credit, including fully liberalizing freight tariffs by the end of 1992. The Government also agreed to begin discussions with the Bank and the IMF with a view to reaching agreement on a comprehensive economic reform program.

1.5 In September 1992, the TGE finalized the first Policy Framework Paper (PFP) covering 1992/93-1994/95, in collaboration with the IMF and the World Bank. The PFP encompassed a broad range of demand and supply side measures to be carried out over a three year period. The PFP involved four main clusters of actions: (a) continued rehabilitation of existing economic and social infrastructure, plus its selective expansion and regular maintenance, (b) macroeconomic stabilization to reduce the large imbalances that characterized the economy, (c) structural reforms to transform the economic system and to provide access to basic social services by the poor, and (d) the establishment and maintenance of an efficient and transitory safety net to cope with the social crisis affecting half of the population. The program received support from the IMF's Structural Adjustment Facility (SAF), which was approved in October 1992. It also received strong endorsement from external donors at a Consultative Group Meeting in Paris in November 1992, and Paris Club negotiations in December 1992 resulted in a rescheduling, on enhanced concessional terms, of Ethiopia's debt service.

1.6 These measures led to some easing of the shortage of foreign exchange. Real output, after falling 3.2 percent in 1991/92, rose by 12.0 percent in 1992/93, due to the improvements in the policy environment combined with extremely favorable weather conditions. Both domestic savings and investment as proportions of GDP increased somewhat in 1992/93, in spite of reduced capital expenditures in the Government budget, reflecting a favorable response on the part of the private sector. The performance of current revenues was disappointing, for while they increased from the extremely low level of 10.6 percent of GDP in 1991/92, they rose to only 12.0 percent in 1992/93. There were indications that the Government was beginning to assert control over basic macroeconomic management, although substantial economic imbalances remained. It was clear that continued macroeconomic stabilization combined with radical structural adjustment measures would be needed to transform the economy and create the basis for sustainable growth.

2. Objectives and Design of the Credit

2.1 This Structural Adjustment Credit (SAC I) emerged as the World Bank's next step in its support for the Ethiopian Government's program of structural reform, as articulated in the PFP. It was intended to support the first phase of the TGE's economic reform program, and to reinforce the measures outlined in the PFP by identifying specific steps that would be taken to make the program an operational reality.

2.2 **Objectives.** The main objectives of SAC-I were to assist the TGE in making a fundamental transformation from a centrally planned to a market-based economy through support for two groups of measures: (a) to aid in implementing a sound macroeconomic stabilization framework, and (b) to address initial constraints to increased participation by the private sector in employment creation. SAC-I also included studies intended to provide background information for the design of later phases of the reform program. The financing provided through the Credit was intended to assist the transition to higher levels of savings and investment and fiscal revenue collection, and an improved current account of the balance of payments.

2.3 The Credit, for US$250 million equivalent, was to be available to finance general imports, and was to be released in two tranches, with the first US$150 million at time of effectiveness. Many of the agreed measures were implemented by the Government before the Credit went to the Board of Executive Directors for approval, and others were designated as either ongoing conditions or actions required for the release of the second tranche of US$100 million. All of the measures were agreed on in general terms in the PFP. The agreed measures are described below.

2.4 **Macroeconomic Stabilization.** This included (a) measures to *remove distortions in key prices*, in view of their adverse effects on resource mobilization and allocation, including the following measures taken before Board Presentation: (i) devaluation of the currency from Birr 2.07 to 5.0 to the US dollar; (ii) upward adjustments in deposit and loan rates and the elimination of distinctions between private and public sector borrowers; (iii) public salary increases of from 5 to 110 percent to improve real wage incentives; and (iv) removal of restrictions on the movement of labor. In addition, agreement was reached on the following measures to be maintained on an ongoing basis during the life of the Credit: (i) the exchange rate would be managed so as to maintain Ethiopia's external competitiveness and minimize smuggling; and (ii) quarterly reviews would be carried out and adjustments made of deposit and loan rates to maintain them at positive real levels.

2.5 This category also included (b) *structural improvements in the fiscal position*, with the following measures taken prior to Board Presentation: (i) personal income taxes were revised to reduce their number and lower the rates; (ii) all export taxes were eliminated except on coffee; (iii) all export subsidies were ended; (iv) a centralized budgeting and accounting system for external grants and counterpart funds was put in place; (v) a procedure was set up to channel all external grants through the budget, to the extent possible; (vi) a public expenditure review for both the central and regional governments, in collaboration with IDA, was initiated; (vii) rental income was to be included in the definition of income for tax purposes; and (viii) training and administrative improvements were initiated in the Inland Revenue and Customs Departments. The following measures were agreed to be carried out prior to the release of the second tranche: (i) by December 1, 1993, the Government would complete a review of the civil service; (ii) corporate and non-corporate profits taxes would be lowered to a rate below the personal income tax rate, and the coverage of sales taxes would be increased by including all consultancy services, advertising, and entertainment; and (iii) the public expenditure review would be completed and an action plan agreed with IDA on the implementation of its findings, and a rolling public investment program would be introduced.

2.6 **Support for the Private Sector.** This included (a) *foreign exchange availability for the private sector*, with the following measures taken before Board Presentation: (i) the TGE instituted a foreign exchange auction for access to foreign currency to procure imported goods, excluding pharmaceuticals, fertilizers, petroleum, official contributions to international organizations and official debt service payments, and certain other items on a negative list; and (ii) the *franco valuta* system of financing imports would be continued[1]. Before second tranche release, the negative list would be modified to make it less restrictive.

2.7 This category of measures included (b) *price control and competitive conditions*, with the following actions taken before Board Presentation: (i) the elimination of the monopoly power of the Agricultural Marketing Corporation and the dismantling of the Domestic Distribution Corporation and the Import Export Corporation; and (ii) the decontrol of all manufactured product prices except for nine tradable goods produced by parastatals (cement, corrugated roofing materials, nails, reinforcement bars, four types of textiles/yarns, and sugar). Before second tranche release, the Government would complete a study for the phased liberalization of the coffee sector, its findings would be reviewed jointly with IDA, and an action plan would be agreed for the implementation of its recommendations.

2.8 Another item under this category was (c) *trade reform*, with the following actions agreed to be implemented through the government budget for 1993/94, due to become effective on July 7, 1993: (i) classification of imported items under the Harmonized System; (ii) conversion of all specific import duties into *ad valorem* rates; (iii) unification of the sales tax on imports and the general sales tax at 12 percent; (vi) application of a maximum duty rate of 80 percent, reduction in the number of zero-tariff product groups from 588 to 77, and reduction in the number of *ad valorem* duty brackets from 25 to 10; (v) review and reduction in the number of classes of importers who receive import duty exemptions, shifting, where possible, as many remaining imports to the "zero-rated" schedule; (vi) streamlining and broadening the scope of the import duty drawback system for exporters to accommodate drawbacks of sales taxes paid on domestic purchases of inputs by exporters and to speed payments; (vii) outlining to IDA a plan for reducing the level and dispersion of import duties over an agreed time horizon; and (viii) reducing license fees (including the annual renewal fee) on coffee exporters, permitting private entry into the marketing and export of gum arabic (with the intention of eventually allowing private production once appropriate environmental safeguards are in place), and eliminating the requirement that traders be members of a Chamber of Commerce.

2.9 The last item in this category was (d) *reducing state ownership of assets*, with the following actions taken before Board Presentation: (i) classification of all public enterprises according to their ultimate ownership status; and (ii) development and issuance of directives to all Government agencies on a policy and mechanism for the retrenchment of public sector employees. The following additional actions were agreed: (i) by December 1993, the Government would complete a study and issue a Government decision for the sale of state-owned houses to the private sector; and (ii) before the second tranche release, the Government would put

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[1] The franco valuta allows importers to import goods without indicating the source of the foreign currency.

up for sale through a public announcement all publicly owned retail shops and at least 29 hotels and restaurants .

2.10 **Groundwork for the Next Phase of Adjustment.** Agreement was reached with IDA prior to Board presentation on terms of reference for studies intended to lay the groundwork for the next phase of adjustment, including sector programming and aid coordination, statistical priorities, financial sector strategy , and poverty monitoring. Also, the Government agreed to undertake institutional strengthening of its auditing and accounting capabilities, and computerization of the core economic agencies and statistical offices.

2.11 **Co-Financing.** The project design provided for cofinancing of CHF 10 million (US$6.8 equivalent) from Switzerland, and Trust Funds of NLG 20 million (US$10.5 million) and SEK 50 million (US$6.5 million) from the Netherlands and SIDA respectively. The IMF supported Ethiopia's structural adjustment program over the period 1992/93-1994/95 by a three year Structural Adjustment Facility (SAF) of SDR 49.4 million.

2.12 **Preparation Process.** The process of reaching agreement on the above measures was lengthy; however, the PFP was helpful in providing a framework for the discussions. IDA staff sought a program to achieve a major transformation from the ineffective centrally planned economy to an efficient market oriented one. While the new Government stated its intent to make a fundamental change from the policies of the previous government, it wanted to move first on measures for which there was a broad consensus among its principal constituencies. It became clear that the new Government officials wanted to have a clear understanding of the consequences of any measures that IDA and the IMF were advocating before agreeing to specific actions. The Government, for example, was not prepared to move ahead on the issue of land ownership, and instead established a practice of land leasing based on an auction system.

2.13 An indication of the political leadership's serious interest in understanding the consequences of alternative courses of action was that all of the top political leadership of the TGE (including the President) took part in a series of training courses and seminars in economics and public and business administration, organized with support from the UNDP and the United Kingdom. This included short courses conducted in Ethiopia by a UK university, correspondence courses, and training abroad. These courses are still being offered and attended by newly appointed senior officials. The TGE leadership was in many cases already educated at the university level, but was not necessarily informed in the fields of economics and administration that now were its central concern. This willingness of the new leaders to seek formal training, in spite of the many other demands on their time, was an unusual indication of their seriousness and dedication.

2.14 The result of the strong degree of commitment on both sides was that negotiations were often protracted (four lengthy negotiating sessions were required to reach agreement on the PFP). The program as finally conceived did not move ahead as far as the IDA staff would have liked in terms of creating a favorable climate for private investment, but nevertheless included major advances in both macroeconomic stabilization and private sector conditions. While IDA undoubtedly convinced the Government to move farther and faster than it would have on its own initiative, the result of the protracted discussions was that the Government always kept control of the process, and could feel a sense of ownership of the final product.

3. Implementation

3.1 Generally, implementation of the specific conditions spelled out in the Credit Agreement was satisfactory, although there were some delays that led to a postponement of the release of the second tranche by ten months, from July 15, 1994 to May 15, 1995 (see Annex C for a summary of all of the conditions and actions taken). The Closing Date was extended by twenty-one months to accommodate the utilization of all of the Credit financing (from December 31, 1994 to September 30, 1996).

3.2 **Conditions of the Credit.** 26 of the agreed measures were put into place before the Credit was signed. Three others required maintaining conditions that had already been achieved by the time of Board Presentation, and only eight additional conditions remained to be carried out during the implementation phase. The three conditions relating to the maintenance of measures already put in place (maintain an appropriate macroeconomic framework to promote stabilization, maintain the exchange rate at an appropriate level to restore Ethiopia's external competitiveness and minimize smuggling, and maintain interest rates at positive real levels for both depositors and borrowers) were all generally adhered to throughout the implementation phase.

3.3 There were, however, some delays in meeting the remaining eight conditions. The civil service review and the study related to the sale of Government owned housing were to be completed by December 31, 1993. However, the civil service review was not completed until April 1996. The Government housing study was completed in February 1995, and the Government subsequently approved a 15 year program to dispose of 423,050 housing units to the private sector. However, only about 26,000 of these units were found to be in "sellable condition", and subsequently the Government announced plans to sell only 30 percent of the total sellable houses during the next five years starting February 1997.

3.4 The six specific conditions included in the Credit Agreement for release of the second tranche were finally met so that the tranche could be released by May 15, 1995. Proclamations relating to income tax rates, sales tax coverage, adoption of a three year public investment program, the sale of Government-owned hotels and restaurants, the reduction of the negative list relating to the foreign exchange auction, and agreement with IDA on the liberalization of the coffee sector all took longer than originally anticipated but were eventually carried out satisfactorily (see Annex C). The duty drawback system introduced in August 1993 did not become fully operational until late 1996 because of bureaucratic problems, at which time the Government issued a new proclamation entitled "A Directive Issued to Regulate the Export Trade Duty Incentive Scheme".

3.5 In some of these cases, the Government simply needed more time to consider the options and to obtain a consensus on what should be done. For others, it was the result of a bureaucracy unfamiliar with a market economy not knowing exactly how to implement complex governmental procedures. In general, however, the Government was scrupulous in carrying out the commitments that it had made during the preparation of the program.

3.6 In a number of cases, the Government went beyond the original targets. For the privatization of state-owned retail shops and other small enterprises, by June 1996, 121 state-owned retail stores and shops, 22 hotels and restaurants, 25 manufacturing enterprises, and 10 agro-industry and small farms had been put up for sale. Of these, 101 retail shops, 13 hotels and restaurants, and 17 manufacturing enterprises had actually been sold. In the field of private sector development, in 1996 the Government enacted revisions in the Investment Code, which further liberalized the investment regime as a step to attract foreign private investment. It permitted private domestic investment in telephone equipment and maintenance; allowed joint ventures of foreign investors with Ethiopian private partners in large-scale engineering and metallurgical industries, capital-intensive and technology-intensive large scale mining, pharmaceutical and fertilizer production, and activities that supply strategic raw materials to chemical industries; allowed Ethiopian private investors to operate on their own in the above areas; and allowed foreign investment in real estate development and smaller hotels. As follow-on actions based on the action plan agreed with IDA, the Government allowed private exporters to sell coffee, rejected for export, to roasters for consumption in the Addis Ababa market, and took steps to ensure that there were no legal, regulatory or other impediments specific to the establishment of washing stations by private investors.

3.7 **Social Safety Net.** While not specifically part of the SAC-I program, it is worth noting that a Welfare Monitoring System was established to monitor the social consequences of the economic reform program and policies and the impact of programs of the poor. A national household income, consumption and expenditure survey and welfare monitoring survey was conducted in 1995/96 for the first time in over a decade. The TGE undertook to reintegrate displaced people and demobilized soldiers into their communities, and to provide training and employment for the disabled and orphans. Timely action by the TGE in 1993/94 avoided widespread famine in a year of substantial food production shortfall. A Social Rehabilitation Fund was set up to support income generation and community efforts to improve essential infrastructure and social assets. In addition, the Government increased its budget allocations for the provision of basic social and economic services. It also developed detailed strategies for overall poverty reduction, population management, education and health, emphasizing improvements in basic services, and ensuring adequate recurrent expenditures for these programs.

3.8 **Procurement and Disbursement.** IDA assisted the Government in learning to implement the IDA procurement procedures by sending procurement specialists to Ethiopia several times to conduct one or two week training seminars in connection with the ERRP that preceded SAC-I. This training was directly applicable to SAC-I, and only a limited amount of additional IDA support was needed for SAC-I procurement purposes. Generally, the record on meeting the Credit Agreement procurement and disbursement procedures was satisfactory. There were occasional instances of noncompliance, some documents pertaining to the selection of suppliers were missing, and some withdrawals were made in respect to goods procured for less than the US$5,000 limit. However, the total amount in question was only about US$0.5 million, which is minor compared to the total Credit amount of US$250 million, and understandable considering the inexperience of the Ethiopian staff with IDA procurement and disbursement procedures.

3.9 **Audits and Accounts.** Section 3.03 of the Credit Agreement specifies that the borrower is required to submit to IDA a certified copy of the audit report not later than 6 months after the end of each fiscal year. The first audit covering FY 1994 was received by IDA in March 1995, approximately three months late. No other audit was received until August 1996, when a single audit for the entire period July 1994 to June 1996 was submitted. Both audits contained minor qualifications.

3.10 **IDA Supervision.** Responsibility for supervision rested with the Task Manager in Washington D.C. but the work was also followed up closely by the Resident Mission. The first supervision mission took place in December 1993. No other supervision missions took place until March 1995, and a final supervision mission took place in June 1996. During 1994 progress was followed by the Resident mission, but without direct intervention from Washington. Supervision reports were prepared for only the last two missions. The Task Manager was changed three times during the life of the project; however, this does not represent as much lack of continuity as it might seem because the second Task Manager, who remained in charge virtually until Credit Closing, had been deeply involved in the preparation of the PFP and of SAC-I, and so was thoroughly familiar with the issues.

4. Outcome

4.1 **Major Accomplishments.** The Government's program of structural adjustment achieved major improvements in both the macroeconomic framework and the investment climate, although with some limitations. The *exchange rate was adjusted* drastically in 1992, and a foreign exchange auction system was introduced that has provided for continuous adjustments in the rate over time. Early auctions regulations included substantial advance deposits and limited the use of auction proceeds, so that the gap between the official rate as established by the auction and the parallel market rate was 18 percent as late as 1996. Subsequent steps to reduce the advance deposit requirement and expand the use of the proceeds has now eliminated the spread, but this was accomplished only after the close of SAC-I. Also, there is still a degree of administrative control over the use of the foreign exchange obtained at auction since import licenses are still required. This leads to some delay in the importing process, and the Government sometimes exercises its authority to reject license applications. Furthermore, given that the Government determines the amount of foreign exchange to be made available at each auction, the auction rate is "managed" to a certain degree. Nevertheless, generally the exchange rate has been maintained at a realistic rate since 1992 as evidenced by export performance and improvements in the balance of payments (see Annex B).

4.2 *Fiscal performance* has also been impressive. Total Government revenues increased from 10.6 percent of GDP in 1991/92 to 18.0 percent in 1995/96. The budget deficit before grants decreased from 10.0 percent of GDP in 1991/92 to 5.4 percent of GDP in 1995/96, in spite of a reduction in tax rates. Allocations for education and health increased from less than 10 percent of the total budget in 1988/89 to almost 30 percent in 1994/95, while military expenditures were reduced from 25 percent to less than 8 percent of the total budget during the same period.

4.3 In addition, *prices have been decontrolled* for almost all goods and services, the *civil service has been reorganized and reduced* in size substantially[2], and *some privatization has been carried out.* These actions, plus the others noted in the previous Chapter such as access to foreign exchange and a recently introduced "one stop" process for obtaining investment licenses, have greatly *improved the climate for the private sector* compared to the situation existing under the previous government.

4.4 The TGE made extensive *changes in the policies and procedures regulating the coffee sector*, which had been totally controlled and operated as a public sector operation under the previous government. The Government monopoly of the Ethiopian Coffee Marketing Corporation was abolished, private traders were allowed virtually free access to enter the market for coffee procurement from farmers, for processing coffee, and for exporting it. The Government continued to be involved in coffee exporting, however, and Government-owned exporting companies now account for about 30 to 40 percent of exports, with the balance handled by the private sector. Also, the Government requires three inspections of the coffee as it advances through the trading system, and exporters are not allowed to make purchases directly from farmers but must obtain the coffee that they wish to export from a Government-operated

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[2] By the end of 1994/95 15,460 civil servants had been retrenched.

auction. The export price for the sale abroad must then meet a Government-established minimum in order to qualify for an export license. The foreign exchange earnings from coffee exports must be surrendered to the Government, although up to 10 percent of the foreign exchange proceeds may be returned to the exporter if he can meet various qualifying requirements. Thus, while the system has been vastly improved from the previous one, it still contains Government controls that restrict to some extent the free trade in coffee.

4.5 **Unfinished Agenda.** Perhaps the best way of putting the Government's accomplishments into perspective is to review the actions still needed to improve the macroeconomic structure and private investment climate, as perceived during the audit review. One indication of the need for further change is that to date Ethiopia has only attracted minimal foreign investment, something which would greatly accelerate the development process. Some of the areas needing attention are described below.

4.6 While the gap between the official and the parallel market rate has been eliminated, at least for the present, there is still room for *improvement in the exchange rate regime.* This includes improving the private sector's access to foreign exchange. Under the present system, the private sector needs to present invoices and obtain import licenses, prior to bidding at auction for the foreign currency. Government approval of the price the importer intends to pay is required. Furthermore, the rigid foreign exchange surrender requirements for exporters, means the cumbersome import procedure cannot be circumvented. All of these requirements increase the time needed for foreign exchange transactions, with a resulting increase in transaction costs and the addition of uncertainties in private operations, making Ethiopia less competitive than countries that have more liberal exchange regimes.

4.7 Perhaps the most important constraint, however, is the present *land use policy*, under which all land is owned by the Government. The land auction system has proved cumbersome, especially as the Government has set floor prices that often seem high to the market, and the negotiated land leases that have replaced the auctions are tedious and are a potential future source of illegal activity. The Government fears that private ownership of land would lead to forced sales by peasants in times of drought, resulting in an increased refugee population and widening income disparities. While these concerns are real and should be addressed, the present system is blocking investment and the accumulation of the means of production by more efficient farmers and company managers, with adverse effects for future growth. The Government has recently agreed with IDA to carry out a study of this issue in an effort to find a satisfactory solution.

4.8 While many constructive changes have been made in the *coffee sector*, additional improvements along the lines suggested by the description of the present system in para. 4.4 should yield even better results in the future. This could include elimination of the Government-controlled auction, reduction in the number of inspections, and elimination of Government control over export prices.

4.9 Another area where progress has been slow has been the *privatization of Government-owned investments* in factories, hotels and a vast array of other services, and housing. While the Government met the modest targets set for SAC-I, it still holds substantial operating companies that would be better placed in the private sector. The Government policy is to privatize these operations, but in practice, auctions have been conducted with what local investors consider to be high floor prices, and there have been few actual sales. The Government is working on this issue, but the actual results have been minimal to date.

4.10 Another area that still requires attention is a ***restructuring of the banking system***. While several small private banks have been established, they lack the capital to make a major impact on private banking operations, which are still dominated by the Government-owned Commercial Bank of Ethiopia, and no foreign bank has yet ventured into Ethiopia. The banking system will be an obstacle to future investment and growth unless improved.

4.11 **Economic Performance During SAC-I.** The measures introduced during the SAC-I period, while they did not complete the reform agenda as outlined above, were sufficient to produce a significant impact on the performance of the economy. At the time that the Ethiopian Government began the preparation of SAC-I, the economy had just completed three years of decline and deterioration caused by the final years of the war, combined with the disastrous policies of the previous government, as described in para. 1.2. Earnings from merchandise exports had declined from US$366 million in 1989/90 to US$154 million in 1991/92, foreign exchange reserves had dropped to US$84 million, equal to only 4 weeks of imports, and government revenues had declined to 10.6 percent of GDP from 17.6 percent in 1989/90. Gross domestic investment had dropped to 8.9 percent of GDP, and gross domestic savings were only 5.3 percent. Infrastructure was in an advanced state of decline due to lack of maintenance, with roads, telecommunications and power generation and distribution facilities deteriorating, and manufacturing plants had virtually no access to foreign exchange for inputs and spare parts.

4.12 The recovery during the program period from the decline of the previous three years was dramatic. In spite of severe drought in 1993/94, real GDP grew by an average of 6.0 percent per annum during 1993/4-1995/96 compared to –5.0 percent per year average during 1990/91-1991/92. Gross domestic investment as a percent of GDP increased to 21.0 percent in 1995/96, and gross domestic savings increased to 6.6 percent in 1995/96 and 9.7 percent in 1996/97 (see Annex B). The estimated share of non-governmental investment in total investment increased from 17 percent before the program period to more than 60 percent in 1995/96, indicating that the measures to stimulate private investment had had a positive effective. Inflation has been reduced to zero. Merchandise exports rose from US$154 million in 1991/92 to US$410 million in 1995/96. The current account deficit (excluding official grants) decreased from around 8.2 percent of GDP in 1992/93 to 1.5 percent in 1994/95, due in large part to strong coffee exports. However, it increased again in 1995/96 to about 7.6 percent of GDP due to declining coffee prices.

4.13 The measures directed at improving the performance of the coffee subsector, which accounts for 50 to 60 percent of Ethiopia's exports, had an especially positive effect. Under the previous government, the incentive to produce coffee was greatly reduced by the low official prices that farmers were forced to accept and the Government monopoly of coffee processing and marketing. Exports dwindled to a low of 32 tons in 1991/92 from 89 tons in 1989/90. Even though the condition for agreeing with IDA on an action plan for the liberalization of the coffee subsector was delayed to March 1995, the adjustment in the exchange rate in 1993 and other preliminary measures instituted by the Government had an immediate effect. Output rose steadily after 1991/92 to an estimated 123 tons in 1996/97, and is expected to continue to increase in 1997/98 and beyond as new coffee plantings undertaken since 1993 come into production. Overall agricultural output also rose during this period, but in an irregular manner due to a severe drought in 1993 and a moderate one in 1997, which also had an adverse effect on GDP in the years following the droughts.

4.14 **Effect of Increased Aid Flows.** A question that may be raised is to what extent increases in GDP were caused by increases in the flow of official aid rather than by changes in policies. While increases in official aid disbursements do not directly translate into increased GDP, they obviously have a positive effect, depending on the uses to which the aid is put and after some lag in time. Annex B shows the net flow of official aid, defined as the total of official grants (less technical assistance grants) plus the net disbursements of official loans and credits. It becomes obvious from the annual changes in aid flows during the program period shown in Annex B that this may have explained some of the increase in GDP in 1992/93 (the year before SAC-I went into effect), since there was an increase in aid flows in the previous year amounting to 2.2 percent of GDP. However, changes in aid flows were negative in every year after 1992/93 through 1995/96.

5. Overall Assessment

5.1 **Overall Outcome.** The project preparation was carried out in a minimal amount of time considering the complexity of the final product. The objectives were clear and straight-forward, and the specific measures included in the design were relevant. While the intensity of the dedication of both sides led to what the IDA staff believed to be some delay in the preparation, the result was a program the TGE felt was its own. There were some shortfalls from the ideal in the areas of the private sector investment climate and privatization, where additional measures might have produced a better response in terms of private investment inflows. However, the overall degree of adjustment was still extremely substantive, and was certainly adequate to justify a first adjustment operation in a country that had functioned for 16 years under a centrally managed economic system.

5.2 Many of the most important measures included in the program design were put in place before the Credit went to the IDA Board for approval. While there were some delays in implementation of the conditions required for second tranche release, the economy was already benefiting from the exchange rate adjustment, reduced tax rates, and improved access to foreign exchange, among others. Generally, the delays of the second tranche measures did not substantially reduce the impact of the program. Ultimately all of the conditions were met or exceeded, and all of the funds were drawn down. Procurement was implemented in a timely manner, and generally in accordance with agreed procedures.

5.3 The program met its objectives as these were described in the President's Report. It aided in implementing the macroeconomic stabilization framework described in the PFP, it addressed initial constraints to increased participation by the private sector in employment creation, and it helped to identify and design later phases of the reform program. Distortions in key prices were removed, the fiscal position was improved, the private sector was given improved access to foreign exchange (although there is still room for further improvement in the access system), price controls have largely been dismantled, trade reform has been carried out, and state ownership of assets has been reduced somewhat. Not only have the specific agreed actions been carried out, but the actions taken by the Ethiopian Government during the program period had a strikingly positive effect on the economy, based on the data set forth in Chapter 4 and Annex B.

5.4 At the same time, it is apparent from the agenda of unfinished actions described in paras. 4.5-4.9 that Ethiopia's transition to a market economy has not yet been completed. In some cases, the Government's actions met the letter of the agreed conditionality while falling short of a fully open, market-based regime. However, as a first step in the adjustment process, it made substantial progress, and set the stage for later additional actions. The Government continues to make additional improvements, even though the pace of change has slowed. Given the progress made, *the overall outcome of this project is rated as satisfactory.*

5.5 **Institution Building.** There was minimal provision for institution building included in the program design, with no specific components in this category except for some assistance in dealing with IDA procurement procedures. The training of Ethiopian staff for this purpose was adequate. A large job remains to train and equip the Ethiopian public service for carrying out its tasks effectively. *The institutional development impact of the program is rated as modest.*

5.6 **Borrower Performance.** Generally, borrower performance was excellent throughout the program cycle. Where delays were involved, these were usually due to wanting to take the time to think through and understand the possible consequences of the actions that the Government was agreeing to. Once agreed, most actions were carried out expeditiously. The Government displayed special commitment to the program through its willingness to undergo special training of its highest officials so that they had a good understanding of the technical economic issues that they were facing. It also had a firm sense of ownership of the program from its inception to the present, which made implementation a common objective of both the Government and the development organizations assisting it. For all of these reasons, *the Borrower performance is rated as satisfactory.*

5.7 **IDA Performance.** The performance of the IDA staff was also at a high level. The project was complicated, and required a thorough knowledge of local market and legal conditions. While IDA pressed the Government to proceed with adjustment on an urgent basis, it did so out of a belief that early action was in the client's best interest. The record of supervision during an extended period in 1994 is unclear, and the reporting is not well documented for this period. Most likely, supervision on the part of the Resident Mission was fully adequate. However, it would have been preferable if this had been better documented by filing the regular Supervision Reports, although this did not materially effect the outcome of the program. Thus, *overall IDA performance is rated as satisfactory.*

6. Project Sustainability

6.1 The changes that have been put into place in the context of SAC-I were undertaken only after the Government had studied them carefully and had concluded that they were in Ethiopia's own interest. The efforts of the political leadership to educate itself in economic theory and practice bodes well for future sustainability, since the Government has a broad understanding of the need for the adopted policies and the consequences of any reversal of them. Also, the results of the changes have been overwhelmingly positive, reinforcing the leadership's belief that the transition to a market economy is the correct way to move in order to realize Ethiopia's desire to raise living standards and address the problems of the poor. Based on the obvious degree of commitment of the Government to the adjustment process, there are strong reasons to believe that the adjustments put in place will be sustained. Thus, *sustainability is rated as likely.*

6.2 There is little doubt that SAC-I encouraged the Government to move faster toward a market economy than it would have done on its own. This is evident from discussions with members of the Government, although it never allowed this pressure to cause it to agree to changes before it understood their consequences. Now that the Government's finances are on a relatively sound footing and income from exports is rising, the pressure to continue the adjustment process is reduced somewhat. This does not imply, however, that the changes already in place will be reversed.

6.3 A recent challenge to sustainability of the adjustment operation is the military activity at the Eritrean border, which could escalate into a level of warfare that would lead to costly military expenditures. One of the Ethiopian Government's signal accomplishments since coming to power was to reduce military expenditures sharply and to reallocate the funds for increased social spending, with expected positive long term effects on growth and development.

7. Lessons from the Project

7.1 The Bank and IDA have had extensive experience in structural adjustment operations, and a number of similar lessons emerge from many of them. This includes the importance of giving attention to institutional capabilities during project preparation, the need for good coordination with co-financiers during implementation, and the importance of clarity of understanding as to the agreed conditions. This operation, however, deserves attention to some other factors that appear to have contributed to the successful outcome.

7.2 **Borrower Commitment.** The Bank has long known that borrower commitment is essential for a successful adjustment operation, but nevertheless frequently moves ahead of the borrower in its eagerness to complete the program and get it under way. In this instance, the IDA staff were also eager to move ahead, but the Ethiopian counterparts insisted on keeping the process at a rate that they could assimilate. This was sometimes frustrating, and led to some delays. However, the final result was one that the Government was committed to, and implemented completely.

7.3 **Education as a Basis for Successful Adjustment.** The most interesting and unique aspect of this project was the training that the political leadership undertook in order to understand what was being proposed and advocated by IDA and the IMF. In a broader sense, all adjustment operations should be made learning experiences for the country's leadership, and perhaps the public as a whole, rather than just a series of changes in procedures and policies. More efforts should be built into these operations with this in mind, including the use of seminars and workshops as well as more formal training, and the use of participatory techniques during project preparation. The potential role for the Bank's Economic Development Institute in this is very high.

7.4 **Desperation as an Incentive for Adjustment.** This is an example of a political leadership that was willing to make fundamental changes in its economic policies because of the depth and urgency of the problems that it faced. The magnitude of the changes, especially considering the deviation from the economic processes with which the leadership was familiar, were undoubtedly only able to be undertaken because the situation was desperate. While some may argue for a more gradual process of change, there is much to support the approach that as many changes as possible should be made before a return to normalcy reduces the incentive for change.

7.5 **Conditionality Implemented Prior to Credit Approval.** One reason that the implementation proceeded smoothly and the impact of the conditionality began to make an economic impact at an early date was that most of the important conditions were put into place by the Government as conditions of Board approval. In this instance, this was facilitated by the PFP discussions that preceded the SAC-I preparation. Nevertheless, a lesson that emerges from this operation is that if major project conditions can be implemented before Board Presentation, this will smooth the way for a successful operation.

Basic Data Sheet

STRUCTURAL ADJUSTMENT CREDIT (CREDIT 2526-ET)

Key Project Data *(amounts in US$ million)*

	Appraisal estimate	*Actual or current estimate*	*Actual as % of appraisal estimate*
IDA	250.0	250.7*	100.3
Cofinancing			
Netherlands	n.a.	10.5	n.a.
Sweden (SIDA)	6.5	6.5	100.0
Switzerland	n.a.	6.8	n.a.
Total	256.5	274.5	n.a.

[a] As a result of SDR appreciation against the US$, and an increase of US$440,000 from IDA reflows.

Cumulative Estimated and Actual Disbursements

	FY94	*FY95*	*FY96*
Appraisal estimate (US$M)	150	250	250
Actual (US$M)	105	195	250.7
Actual as % of appraisal	70%	78%	100.3%

Date of final disbursement: September 30, 1996

Project Dates

	Original	*Actual*
Initiating memorandum	10/16/92	10/16/92
Appraisal	1/14/92	1/14/92
Negotiations	5/6/92	5/6/92
Board approval	6/29/92	6/29/92
Signing	6/30/92	6/30/92
Effectiveness & First Tranche Rel.	9/28/92	7/15/92
Second Tranche Release	7/15/94	5/15/95
Loan Closing	12/31/94	9/30/96

Staff Inputs (staff weeks)

	Total
Preparation to Appraisal	43.9
Appraisal through Board Approval	35.0
Supervision	22.4
Completion	10.9
Total	108.6

Mission Data

	Date (month/year)	*No. of persons*	*Staff days in Field*
Identification/Prepara.	Oct/Nov-92	2	12
Appraisal	Jan/Feb/-93	4	15
Supervision I	Dec-93	2	10
Supervision II	Mar-95	2	9
Supervision III	Jun-96	2	9

Other Project Data

Borrower/Executing Agency: Government of Ethiopia

Follow-On Operations	*Purpose*	*Year of Approval*	*Status*
Calub Energy Development Project (Credit 2588-ET)	To augment the availability of Ethiopia's indigenous energy resources in an economically viable, and commercially and environmentally sustainable manner	1994	Implementation under way. Closing date-12/31/00.
National Seeds Project (Credit 2741-ET)	To support increased agricultural production and productivity by laying the foundation for the development of a broad-based and competitive seed industry.	1995	Same.
National Fertilizer Project (Credit 2740-ET)	To support sustainable growth in agriculture by supporting policy reforms to create an enabling environment for the growth of a competitive fertilizer sector, institutional and human resource capacity building, strategies that enhance effective fertilizer demand and match them with adequate supplies, initiatives to maintain and improve the long-term fertility of Ethiopian soils, and environmental conservation.	1995	Same.
Water Supply Dev. And Rehab. (Credit 2842-ET)	To ensure the long term viability of water supply and sanitation operations through building the capacity of the regional governments and water supply and sanitation agencies, and assisting to formulate policies to ensure long term financial and managerial viability of water supply operations.	1996	Implementation under way. Closing date-6/30/00.
Ethiopian Social Rehabilitation and Development Fund (ESRF) (Credit 2841-ET)	To expand the operations of the ESRF to all regions of Ethiopia in order to provide financial and technical support to poor, mainly rural communities for starting small projects aimed at creating the assets and services needed to upgrade their economic and social standards and strengthen self-reliance.	1996	Implementation under way. Closing date-12/31/01.

Table 1. Selected Indicators Prior to the Credit[1]

	1989/90	*1990/91*	*1991/92*	*1992/93*
GDP Growth (% change)	3.4	-6.7	-3.2	12.0
Resource Balance (% GDP)	17.5	-31.7	-33.9	61.4
Exports (% GDP)	-2.1	-23.8	-46.8	83.9
Imports (% GDP)	-19.6	7.9	-12.9	22.5
Consumption per capita (%change)	-2.6	-6.7	-20.3	12.9
Consumer prices (% change)	5.2	20.9	21.0	10.0
Gross Domestic Investment (% GDP)	8.9	7.1	9.2	14.2
Public (% GDP)	6.4	4.3	3.3	5.0
Private (% GDP)	2.5	2.8	5.9	9.2
Gross Domestic Savings (% GDP)	4.6	0	5.3	5.6
Private (% GDP)	5.1	1.7	2.6	4.2
Gross National Savings (% GDP)	6.4	1.6	8.2	9.7
Gov't Def/Surpl. excl. grants(% GDP)	-12.0	-11.2	-10.0	-7.6
Total Gov't Revenues (% GDP)	17.6	13.7	10.6	12.0
Total Gov't Expenditures (GDP)	29.6	24.9	20.6	19.6
Agriculture Value Added (% Change)	5.2	2.2	-2.7	6.1
Coffee Exports (000 metric tons)	88.9	58.2	32.3	67.4
Foreign Direct Investment (US$million Net)	12	6	6	7
Net Aid Flows (US$million)*	862	904	1050	882
Annual Change in Aid Flows as a % of GDP		0.6	2.2	-2.2

[1] *Source*: various Government of Ethiopia, IMF and World Bank documents.

* Aid flows are defined as grants disbursed (less technical assistance grants) plus net disbursements of official loans and credits.

Table 2. Selected Indicators Following the Credit[1]

	1993/94	*1994/95*	*1995/96*	*1996/97*
GDP Growth (% change)	1.7	5.4	10.6	5.3
Resource Balance (% GDP)	29.0	1.6	-21.9	46.4
Exports (% GDP)	17.1	10.2	4.9	48.0
Imports (% GDP)	-11.9	8.6	26.8	1.6
Consumption per capita (%change)	2.5	0.5	7.9	8.6
Consumer prices (% change)	1.2	13.4	0.9	-6.4
Gross Domestic Investment (% GDP)	15.1	15.7	21.0	20.3
Public (% GDP)	9.0	7.3	7.4	8.3
Private (% GDP)	6.1	5.4	13.6	12.0
Gross Domestic Savings (% GDP)	5.0	6.7	6.6	9.7
Private (% GDP)	2.6	1.5	0.3	2.0
Gross National Savings (% GDP)	9.6	13.6	13.3	13.2
Gov't Def/Surpl. excl. grants(% GDP)	-12.0	-7.6	-5.4	-6.5
Total Gov't Revenues (% GDP)	13.9	17.4	18.0	18.0
Total Gov't Expenditures (GDP)	25.9	25.0	23.4	24.5
Agriculture Value Added (% Change)	-3.7	3.4	14.7	3.4
Coffee Exports (000 metric tons)	69.2	82.2	97.6	123.2
Foreign Direct Investment (US$million Net)	3	8	5	
Net Aid Flows (US$million)*	810	631	592	
Annual Change in Aid Flows as a % of GDP	-1.1	-2.7	-0.6	

[1] *Source:* various Government of Ethiopia, IMF and World Bank documents.

* Aid flows are defined as grants disbursed (less technical assistance grants) plus net disbursements of official loans and credits.

Ethiopia—Structural Credit I – Implementation of Adjustment Measures

Reform Objectives and Areas for Action	*Agreed Actions*	*Originally Agreed Date and ActualPerformance*
A. Support for Macroeconomic Stabilization		
I. Correct distortions in key prices to improve efficiency of resource mobilization and allocation.	a) Maintain an appropriate macroeconomic framework to promote stabilization.	Was continuously maintained, as agreed
	b) Devaluation from Birr 2.07 to Birr 5 per US Dollar—59 percent in Dollar terms.	Completed prior to Board
	c) Upward adjustment in interest rates on deposits and credits.	Completed prior to Board
	d) Public sector salary adjustments to compensate partly for recent real wage declines.	Completed prior to Board
	e) The exchange rate will be maintained at an appropriate level to restore Ethiopia's external competitiveness and minimize smuggling.	Was continuously maintained, as agreed
	f) Interest rates will be reviewed at three month intervals to maintain them at positive real levels for both depositors and borrowers.	Was continuously maintained, as agreed
II. Lower the fiscal deficit and provide for appropriate means of domestic financing in order to reduce the internal imbalance and maintain low and stable rates of inflation. Increase revenue buoyancy while reorienting it towards the needs of a market economy. Reduce government expenditure, curtailing outlays with little economic social benefit, reduce subsidies and ensure their transparency, and prioritize and rationalize recurrent expenditure and investment.	Revenues:	
	a) Revise the personal income tax structure, raise the threshold for taxation, reduce the number of brackets, and lower the highest marginal tax rate.	Completed prior to Board
	b) Except for coffee, drop all export taxes.	Completed prior to Board
	c) Agreement will be reached on the taxation of rental income, to begin in 1993/94.	Completed prior to Board

Reform objectives and Areas for action	*Agreed Actions*	*Originally agreed date, and actual performance*
	d) Strengthen the current program of training and administrative improvements in the Inland Revenue Authority and the Customs Authority, and initiate studies for further improvements, including the following measures: (i) training courses, (ii) preparation of work manuals, and (iii) establishment of separate departments for tax fraud and criminal investigation.	Completed prior to Board
	e) Initiate procedures for the centralized budgeting and accounting of counterpart funds and require external grants to be channeled through the budget.	Completed prior to Board
	f) Corporate and noncorporate profits taxes will be reviewed and adjusted to have the same marginal rate of not more than the personal income tax rate, and their base would be broadened to include at least capital gains.	To be completed by second tranche (7/15/94)- actual was 10/26/94
	g) The coverage of sales taxes will be increased by including all consulting services, advertising and entertainment.	To be completed by second tranche (7/15/94)- actual was 8/16/94
	Expenditures:	
	a) Eliminate or reduce export subsidies.	Completed prior to Board
	b) Initiate the first round of a public expenditure review by Board Presentation, and once the review is completed, increase the efficiency of public expenditures by implementing its recommendations in the government budget of 1994/95 and introducing a three-year rolling public investment program.	To be completed by second tranche (7/15/94)- actual was 10/21/94
	c) Complete the civil service review agreed in the PFP.	Original schedule-December, 1993; actual April 1996

Reform objectives and Areas for action	*Agreed Actions*	*Originally agreed date and actual performance*
B. Private Sector Development		
I. Redefine boundary between public and private economic activity.	Actions are proposed on several fronts:	
	a) A study will be completed and a government decision issued for a phased program to sell government-owned houses to the private sector.	Original schedule-December 1993; actual February 1995
	b) All public enterprises will be categorized according to their ultimate ownership status.	Completed prior to Board
	c) State-owned retail shops, and at least 29 hotels and restaurants will be put up for sale through public announcement.	To be completed by second tranche (7/15/94)- actual was 4/25/95
II. Promote price signals and the operation of competitive markets.	1. Price decontrol will be continued in the following manner:	
	a) All manufactured product prices will be decontrolled with the exceptions noted below, and the concerned parastatal managers so notified.	Completed prior to Board
	b) The monopoly power of parastatals producing tradable goods will be ended. The prices of nine tradable goods produced by the facto monopoly suppliers will be adjusted on the basis of import parity plus an amount up to prevailing duty.	Completed prior to Board
	2. The monopoly power of official distribution and trade corporations—Domestic Distribution, Export-Import Agricultural Marketing—will be eliminated.	Completed prior to Board
	3. A study for the phased liberalization of the coffee sector will be completed, its findings reviewed with IDA, and agreement will be reached on an action plan to implement its recommendations.	To be completed by second tranche (7/15/94)- actual was 4/20/95

Reform objectives and Areas for action	*Agreed Actions*	*Originally agreed date and actual performance*
III. Improve private sector access to critical inputs, chiefly foreign exchange.	a) Private sector and parastatal producers will be given access to foreign exchange, through a mechanism satisfactory to IDA.	Completed prior to Board
IV. Rationalize the import tariff regime, initially to increase revenue buoyancy while making protection transparent. Subsequently, import duties will be used mainly for protective purposes. Provide exporters with speedy access to imported inputs at international prices, and reduce marketing and regulatory costs.	The first phase of import reforms will consist of the following measures:	
	a) Complete the classification of imported items under the Harmonized System.	Completed prior to Board
	b) Convert specific import duties into *ad valorem* rates	Completed prior to Board
	c) Review and implement changes in the standard rate of sales tax on imports.	Completed prior to Board
	d) Implement changes in the tariff structure by reviewing all "zero" tariffs, applying a maximum duty rate of 80 percent and reducing a number of duty brackets to 10	Completed prior to Board
	e) Reduce the number of categories of importers who currently receive import duty exemptions.	Completed prior to Board
	f) Indicate in the Letter of Development Policy a plan for substantially reducing the level and dispersion of import duties over an agreed time horizon.	Completed prior to Board
	g) Reduce the size of the negative list to liberalize imports further by eliminating *at least* the following items: number 245 to 248, 634, 635, 663, 693, 699, and 893.	To be completed by second tranche (7/15/94)- actual was 2/3/95.
	The removal of current biases against exports will occur through:	
	a) Streamlining and broadening the scope of the import duty drawback system.	The duty drawback system was introduced prior to Board, but did not become fully operational until late 1996.

Reform objectives and Areas for action	*Agreed Actions*	*Originally agreed date and actual performance*
	b) Identification and removal of specific marketing and regulatory constraints on the expansion of exports.	Completed prior to Board
V. Retrenchment Safety Nets.	Develop and issue directives to all government agencies on a policy and mechanism for public sector employee retrenchment.	Completed prior to Board
C. Groundwork for Next Phase of Structural Adjustment		
I. Information systems and institutions required to support further development of the private sector should be upgraded.	Agreement on action plans for computarization of the core economic agencies and statistical offices, and for strengthening auditing and accounting capabilities.	Completed prior to Board
II. Develop sectoral and institutional knowledge to underpin the design of further structural adjustment measures.	Agreement on terms of reference for the following studies: sector programming and aid coordination, statistical priorities, financial sector strategies, and poverty monitoring.	Completed prior to Board