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Report No. 35142-ET

INTERNATIONAL DEVELOPMENT ASSOCIATION

INTERIM COUNTRY ASSISTANCE STRATEGY

FOR

THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

May 1, 2006

Ethiopia Country Management Unit
Africa Region

DATE OF LAST COUNTRY ASSISTANCE STRATEGY
March 24, 2003

GOVERNMENT FISCAL YEAR
July 8—July 7

CURRENCY EQUIVALENTS
US$1.00 = Ethiopian Birr 8.73 (as of May 1, 2006)

ABBREVIATIONS AND ACRONYMS

AAA	Analytical and Advisory Activities
AfDB	African Development Bank
AIDS	Acquired Immune Deficiency Syndrome
ADLI	Agricultural Development Led Industrialization
APL	Adaptable Program Loan
APR	Annual Progress Report
BOP	Balance of Payments
CAS	Country Assistance Strategy
CB	Capacity Building
CBAS	Capacity Building for Agricultural Services Project
CBDSD	Capacity Building for Decentralized Service Delivery Project
CDD	Community Driven Development
CEM	Country Economic Memorandum
CPA	Country Program Assessment
CPI	Consumer Price Index
CPIA	Country Policy and Institutional Assessment
CPPR	Country Portfolio Performance Review
CSA	Central Statistical Authority
CUD	Coalition for Unity and Democracy
DAG	Development Assistance Group
DO	Development Objectives
EEBC	Ethiopia-Eritrea Border Commission
EEPCO	Ethiopian Electric Power Company
EPRDF	Ethiopian Peoples' Revolutionary Democratic Front
ERL	Emergency Recovery Loan
ESW	Economic and Sector Work
ET	Ethiopia
EU	European Union
FDI	Foreign Direct Investment
FY	Fiscal Year
GDP	Gross Domestic Product
GEF	Global Environment Facility
GoE	Government of Ethiopia
GNFS	Goods and Non-Factor Services
HEP	Health Extension Program
HICES	Household Income, Consumption, and Expenditure Survey
HIV	Human Immunodeficiency Virus
HSDP III	Third Health Sector Development Program
ICA	Investment Climate Assessment
ICAS	Interim Country Assistance Strategy
IDA	International Development Association
IFC	International Finance Corporation
IGAD	Intergovernmental Authority on Development
IGR	Institutional and Governance Review
IMF	International Monetary Fund
IP	Implementation Progress
JBAR	Joint Budget and Aid Review
KM	Kilometers
KM^2	Square Kilometers
KWH	Kilowatt Hours
LIG	Local Investment Grant
LIL	Learning and Innovation Loan
M&E	Monitoring and Evaluation
MAP	Multi-sectoral HIV/AIDS Program
MDGs	Millennium Development Goals
MIGA	Multilateral Investment Guarantee Agency
MOFED	Ministry of Finance and Economic Development
NBE	National Bank of Ethiopia
NBI	Nile Basin Initiative
NEPAD	New Partnership for African Development
NGO	Non-Governmental Organization
OED	Operations Evaluation Department
ODA	Official Development Assistance
OLS	Ordinary Least Squares
PASDEP	Plan for Accelerated and Sustained Development to End Poverty
PBS	Protection of Basic Services
PER	Public Expenditure Review
PRSC	Poverty Reduction Support Credit
PSCAP	Public Sector Capacity Building Program
PSD	Private Sector Development
QAG	Quality Assurance Group
SDPRP	Sustainable Development and Poverty Reduction Program
SIL	Specific Investment Loan
U5	Under Age 5
UNDP	United Nations Development Programme
USD	United States Dollar
WBI	World Bank Institute

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INTERIM COUNTRY ASSISTANCE STRATEGY
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EXECUTIVE SUMMARY

i. Ethiopia's performance on growth and human development in recent years has been strong, and an upcoming nationwide household survey is likely to confirm a significant decline in poverty. However, following disputed parliamentary elections, political tensions in the country have mounted, with a number of significant risks for development.

ii. ***On May 15, 2005, the first openly contested elections in Ethiopia's history were held,*** with a large voter turnout. Official results showed a victory for the ruling party, but large gains for the opposition, especially in the capital of Addis Ababa. Observers noted numerous electoral irregularities, while the opposition claimed victory. Large demonstrations in June and November resulted in loss of life and mass arrests of demonstrators, journalists, and opposition leaders. While there are some recent positive developments that give hope for a peaceful resolution of the crisis, the political climate remains characterized by a lack of trust among the parties and the potential for further unrest remains. In response to these developments, the Bank and donor partners committed to: (i) move away from direct budget support in favor of alternative instruments that would provide greater oversight over poverty reducing expenditures and promote increased accountability; (ii) reduce aid over time if governance does not improve; and (iii) focus on new governance programs.

iii. ***Economic growth performance over the past two years has been strong and broad-based.*** After a significant drought-induced contraction, real GDP growth was 8.9 percent in 2004/05, following an 11 percent growth rate rebound in 2003/04. Growth above the long-term trend is also expected in 2005/06. However, rising oil prices, a freeze in direct budget support, increased demand for imports due to fast economic growth, and an ambitious infrastructure investment program have strained Ethiopia's balance of payment situation. To maintain macroeconomic stability, Government has delayed portions of its public investment plan.

iv. ***Ethiopia has made important gains on human development indicators since it began decentralizing basic service delivery responsibilities***—first to regions, in the mid-1990s, and then more recently to local governments. These gains have been fueled by an increase in pro-poor spending from 39 percent of the budget in 1999/2000 to 54 percent in 2005/06. Still, recent gains have been from a low base, and reaching MDG targets remains challenging. Accelerating progress toward the MDGs will require large increases in ODA; but even more crucially, it will demand an enhanced institutional capacity building and governance reform agenda that will allow effective scaling-up of service delivery in a transparent and accountable manner.

v. ***Good governance is vital for economic growth.*** While growth performance has been good in recent years, continued strong growth will require accelerated private sector development, both in urban and rural areas, and good returns on infrastructure investments. Business confidence has suffered in the aftermath of the elections, and the polarized nature of Ethiopian society holds risks for the growth of the private sector. These risks increase the need for strengthened institutions, such as the judiciary, to mediate conflict and to

ensure that all firms irrespective of political affiliation are able to enforce their contractual and property rights, such that economic merit alone determines the rules of exchange and market outcomes. Ethiopia's massive infrastructure needs argue strongly for continued investment. But as in any country, in order to achieve an adequate development payoff from infrastructure investments, care must be taken to ensure that the locations of the investments are chosen based on where they will be most productive.

vi. ***In light of the above, this Interim Country Assistance Strategy (ICAS) focuses on both good governance and growth as the central underpinnings of the Bank's support to Ethiopia.*** Working together with donor partners (who are expected to take the lead on more explicitly political elements of the governance agenda), the Bank's overarching objective in this ICAS is to support Government in developing and implementing, in consultation with citizens, a strengthened program of institution building and governance reform that will help in its efforts to accelerate pro-poor growth. To achieve this objective, the Bank will deepen support in ways that strengthen good governance and growth in the following areas: (i) "core" governance—public administration, decentralization, and public financial management; (ii) the provision of basic services in a fair and accountable way; (iii) the promotion of free enterprise; (iv) improved agricultural productivity; and (v) the development of infrastructure to nurture the growth of small towns and growth corridors.

vii. ***As opposed to a full CAS, the shorter timeframe of an Interim Strategy was deemed to be more appropriate in order to allow for a transitional period*** where Government, stakeholders, the Bank, and partners could develop consensus around a strengthened governance agenda. In this regard, the Bank and development partners have agreed with Government on a framework for dialogue on issues of governance, with participation from civil society. As dialogue progresses over the medium term, this multi-donor approach will shift to supporting the implementation of agreed institutional reform measures to improve checks and balances, and strengthening the ability of the state to serve the development needs of its citizens.

viii. ***The ICAS proposes a lending program of around $491 million in FY06.*** The projected FY07 IDA envelope is a range: the upper boundary based on the ceiling given by the IDA allocation formula for FY07 plus the carry-over of unused IDA resources from FY06, and a lower bound (up to 30 percent reduction) reflecting a low case scenario. The criteria for determining the FY07 envelope within this range are the performance indicators contained in the ICAS Results Framework, covering public expenditure management and financial accountability, civil service incentives, budget transparency, fairness and accountability in delivery of basic services, the investment climate, agricultural policies, and progress in implementation of infrastructure investments.

ix. The following issues are suggested for discussion by the Executive Directors:

- Is the proposed strategy, including the enhanced emphasis on governance, an appropriate response to the recent evolution of the country context in Ethiopia?
- Are the levels of assistance and the proposed criteria for modulating IDA support in line with Ethiopia's development challenges?

INTERIM COUNTRY ASSISTANCE STRATEGY
FOR
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I. INTRODUCTION

1. The last Country Assistance Strategy (CAS) for Ethiopia, discussed by the Board on March 24, 2003, covered the period from FY03-05. The CAS was based on the country's first poverty reduction strategy, the Sustainable Development and Poverty Reduction Program (SDPRP). A CAS Progress Report, presented to the Board on August 25, 2004, outlined the progress that had been achieved so far in CAS implementation, and recommended a continuation of the existing program until a new strategy was prepared.

2. In recent months, events in Ethiopia have reinforced the notion that good governance[1] is central to the development effort. Accordingly, this Interim Country Assistance Strategy (ICAS) sets out a program of assistance for Ethiopia designed to focus the Bank's engagement more frontally on *governance*—with the recognition that in a more polarized society, where the risk of political capture is increased, the need for good governance is more important than ever. As part of a broader multi-donor effort, the strategy's overarching objective is to support Government in developing and implementing, in consultation with citizens, a strengthened program of institution building and governance reform that will help to accelerate pro-poor growth. This strategy reflects the necessity of continued investments to support long-term economic *growth*, and recognizes the importance of good governance in promoting economic growth by raising investor confidence and promoting free enterprise, building infrastructure rapidly, improving the provision of critical basic services for poor people, managing vulnerabilities, and preserving the potential for scaling-up of ODA by protecting institutional capital.

3. The World Bank had originally planned to prepare a new, three-year results-based CAS for Ethiopia for FY06-FY08. This CAS would have been aligned with Ethiopia's new poverty reduction strategy, called the Plan for Accelerated and Sustained Development to End Poverty (PASDEP), currently being finalized. It would have also reflected a scaling-up of Bank and donor financing to Ethiopia in line with commitments made at the G8 Summit at Gleneagles. However, in light of the postponement of scaling up in the near term, and to allow time for Government, stakeholders, the Bank, and partners to develop consensus around a strengthened governance agenda, a shorter timeframe was judged to be more appropriate. The ICAS will cover the remainder of FY06 and all of FY07. Depending on the progress on the governance agenda, either a new three-year CAS or an updated interim strategy would be prepared beginning in FY08.

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[1] The 1994 report *Governance: The World Bank's Experience* defined good governance as "predictable, open, and enlightened policymaking (that is, transparent processes); a bureaucracy imbued with a professional ethos; an executive arm of government accountable for its actions; a strong civil society participating in public affairs; and all behaving under the rule of law."

II. COUNTRY CONTEXT

A. Political Context

4. On May 15, 2005, the first openly contested elections in Ethiopia's history were held. The election was preceded by a series of unprecedented and open public debates between the ruling party and the opposition parties. The Government pledged its commitment to a clean process, the sanctity of the votes, and dialogue between the parties. On election day, voting was remarkably peaceful, according to international observers, and voter participation was high. Official election results showed that the ruling Ethiopian People's Revolutionary Democratic Front (EPRDF) had retained a majority in Parliament, while the opposition increased its number of seats from 12 to 172 seats out of 546, and gained control of the Addis Ababa city government. The groups monitoring the elections (the European Union, the African Union, and the Carter Center) found a number of areas where elections did not conform to international standards. Most of the opposition disputes the result.

5. However, the aftermath of the elections has demonstrated the fragility of the democratization process. Election-related violence began in June. Many members of the largest opposition party, the Coalition for Unity and Democracy Party (CUDP), boycotted Parliament, and refused to take up the administration of Addis Ababa. The simmering tensions boiled over again in early November, when clashes occurred between civilians and government security forces in Addis Ababa and several other cities. Thousands of civilians were arrested, including journalists and key opposition leaders such as the CUDP's President and Chairman.

6. The recent evolution of the political situation points to possibilities for both positive and negative developments in the near term. On one hand, while most of the opposition initially boycotted Parliament, now only about 20 of 172 elected opposition parliamentarians have not taken up their seats. There has been progress towards the formation of an opposition-led city government in Addis. While Government had changed parliamentary rules after the election to limit the power of the opposition, authorities are now open to reversing these restrictions, as well as revising the media law to be more in line with international best practice. On the other hand, key opposition leaders and journalists still remain jailed, and trials on charges of treason began on February 23, 2006. The political climate remains characterized by a lack of trust among the parties and the possibility of further unrest remains.

7. The Ambassadors group in Addis Ababa has been active throughout the period. The US and EU ambassadors asked the Government to undertake a series of initiatives to defuse current tensions and improve the overall governance climate. The Donor Assistance Group (DAG) of development partners, co-chaired by the World Bank, stated its position in a joint statement issued on November 11, 2005. In this statement, partners agreed to: (i) move away from direct budget support in favor of alternative instruments that would provide greater oversight of poverty reducing expenditures and promote increased accountability; (ii) reduce aid over time if governance does not improve; and (iii)

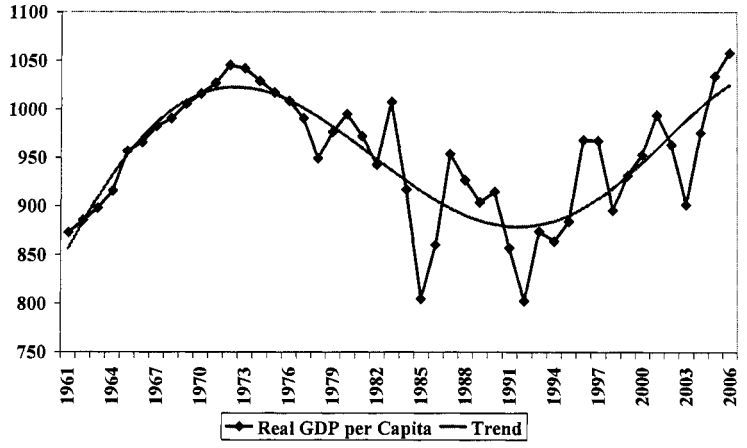
focus on new governance programs. For the Bank, the decision to freeze budget support through the PRSC instrument was based on the recognition that in an increasingly divided environment, a new instrument was needed to ensure that resource flows to local authorities could be protected from political capture through an enhanced set of checks and balances.

8. In parallel, tensions between Eritrea and Ethiopia regarding the unresolved demarcation of the border remain elevated. Both sides agreed ex ante to abide by the decision of the Ethiopia-Eritrea Border Commission (EEBC), established under the auspices of the United Nations. Ethiopia has not implemented the April 2002 ruling of the Border Commission that required it to withdraw from the town of Badme, which has been awarded to Eritrea. While Ethiopia recognized the ruling of the Border Commission "in principle" in November 2004, the Government still seeks dialogue with Eritrea on its implementation. Eritrea, on the other hand, calls for immediate implementation of the ruling. The U.N. Security Council has urged both countries to take measures to resolve the conflict. However, international efforts to resolve the current stalemate have not borne fruit to date.

B. Macroeconomic Context

9. Economic growth performance over the past two years has been very strong and broad based, with the result that GDP per capita has finally caught up to pre-Derg levels (figure 1). After a significant drought-induced contraction, Ethiopia's economy rebounded in 2003/04 and 2004/05 with rapid broad-based growth driven by strong agricultural performance. Real GDP growth was 8.9 percent in 2004/05, following an 11 percent growth rate rebound in 2003/04 (table 1). Growth was driven by a strong agriculture sector (12.1 percent growth), but also reflects good performance across sectors (6.6 percent in industrial production, and 5.8 percent in services). The IMF expects growth of 5.1 percent in 2005/06, though Government predicts higher growth of 8 percent. At the end of December 2005, consumer prices had risen by 11.7 percent in the previous twelve months, compared to 6.8 percent in June. Food prices have been increasing more rapidly than the overall level of inflation.

Figure 1: Real GDP per Capita (Ethiopian Birr)



Note: 1990/00 constant prices; 2006 is projected

10. Macroeconomic stability has been a critical underpinning both to the foundations for economic growth, and increased levels of development assistance that have flowed through the budget until recently. However, a confluence of negative

factors has recently required the Government to take decisive action to ensure continuation of the long-run trend of macro-stability. While exports grew strongly in 2004/05, imports have grown even faster. Due to rising oil prices, increased demand for imports due to fast economic growth, and an ambitious infrastructure investment program, Ethiopia's balance of payment situation has shown increasing fragility.

11. Accordingly, Government has taken steps to delay portions of its public investment plan (in energy and telecom) in light of the need to bridge a BOP financing gap, indicated that the oil import bill is expected to be lower than initially estimated, and held transfers from the NBE to the budget at a lower level than initially proposed. The IMF has indicated that the Government's proposals appear to be an adequate response to maintain macro stability.

Table 1: Selected Macroeconomic Indicators

	1998/99	1999/00	2000/01	2001/02	2002/03 (prelim.)	2003/04 (prelim.)	2004/05 (prelim.)	2005/06 (proj.)
			(percent growth)					
GDP at factor cost	7.1	5.3	7.4	-0.3	-3.8	11.3	8.9	5.1
Agriculture	4.3	3.2	10.7	-2.3	-11.6	17.7	12.1	4.7
Industry	7.1	3.6	4.8	5.1	5.5	6.8	6.6	6.3
Services	11.5	8.9	3.8	0.5	3.3	5.8	5.8	5.4
Inflation (CPI)	4.8	6.2	-5.2	-7.2	15.1	8.6	6.8	10.8
Food CPI	9.0	8.6	-10.6	-12.7	24.8	11.8	7.7	
Non food CPI	-2.0	1.8	4.9	1.6	1.6	3.2	5.4	
External sector								
Exports (GNFS)	-11.9	7.6	-0.5	0.4	16.0	31.4	22.1	20.7
Imports (GNFS)	13.3	4.6	-1.2	7.1	13.2	35.1	37.7	20.9
			(period average)					
Exchange rate (Birr/US$)	7.51	8.15	8.33	8.54	8.58	8.62	8.65	

12. Even taking into account the positive steps Government has taken to scale back its investment plans, there remain other dimensions where prudent political decisions will be important for overall economic stability. First, it will be important to attract more ODA and FDI, which will require rapid improvement in governance. Second, Ethiopia faces several key fiscal pressures for which adjustment is desirable from an economic point of view but problematic from a political perspective. While global oil prices have risen, government has not increased domestic fuel prices since December 2004, resulting in a large fuel subsidy. Similarly, while Government has recently approved an electricity rate increase of about 22 percent, tariffs remain well below the level that would ensure sustainability of the state-owned Ethiopian Electric Power Company (EEPCO), and further tariff adjustments will be required over time. Given that consumption of fuel and

electricity is heavily skewed towards higher income levels, these policies use resources that could otherwise be used for pro-poor expenditures such as basic services and infrastructure. However, since consumers of fuel and electricity are also disproportionately located in urban areas—where opposition support is strongest—Government faces a difficult decision on whether and how to raise prices to sustainable levels, especially considering the already high levels of food price inflation.

13. On March 28, 2006, the World Bank's Board of Executive Directors approved 100 percent cancellation of Ethiopia's debt to IDA, as part of the Multilateral Debt Relief Initiative (MDRI). The Executive Board of the IMF had already approved cancellation of debt owed to the Fund under MDRI in December 2005, and the African Development Bank also approved debt relief under MDRI in April 2006. A joint World Bank-IMF Debt Sustainability Analysis (DSA), completed before approval of IDA's MDRI debt relief, concluded that Ethiopia's risk of debt distress was moderate. Still, while debt indicators remained within the limits of sustainability under a baseline scenario, stress tests revealed that the favorable outlook under the baseline did not provide sufficient comfort against adverse developments, in particular to less favorable terms for external financing and to exports shocks. The Bank and Fund are in the process of preparing an updated DSA to reflect cancellation of IDA debt under MDRI.

C. Poverty

14. The ongoing update by the Government of the Household Income, Consumption, and Expenditure Survey (HICES)—expected soon—will provide the first comprehensive update on the progress achieved in poverty reduction since 1999/00, when the poverty rate was measured at about 44 percent. Initial indications are that the forthcoming HICES update will show a notable decline in poverty, which was also suggested by the recently completed Poverty Assessment. Still, the Poverty Assessment estimates that the overall progress in reducing poverty since 1992 remains less than what is required to meet the MDG of halving poverty by 2015, due to weak and highly variable agricultural growth accompanied by the rapid expansion in the country's population.

15. Rapid population growth has worked against efforts to reduce poverty. Ethiopia's population growth rate during 2000-2005 was 2.44 percent per annum, compared to the sub-Saharan African average of 2.28 percent for the same period. It has a population density which is twice the average for Sub-Saharan Africa. The density is greatest in the highlands where, as a result, soil fertility is rapidly declining, and average plot sizes have decreased in many cases below the minimum amount required for subsistence. If the rate of population growth does not decline, it is expected that Ethiopia's population of 70 million will double in about 25 years, affecting savings and capital formation, and heightening the challenge of achieving the MDGs.

16. Among the rural population, the main source of income for 87 percent of households is subsistence agriculture. The income levels are not only low but highly variable, subject to periodic climatic shocks. The primary asset to cushion weather shocks is livestock (72 percent households own cattle) but the ownership of other physical assets

is extremely low (e.g., only 14 percent of the households own a radio while less than one percent own a bicycle). Production of cereal is equivalent to the average for Africa, but the average caloric intake, at 1,840 calories per day, is 17 percent below the African level. Approximately 7 to 8 million people are counted as chronically food insecure; that is, they cannot feed themselves for more than 6 months even in a year when drought does not occur. The severe drought of 2002/03, which put 14 million at risk of starvation, is feared to have led to increased levels of chronic food insecurity, as transitory victims of drought liquidated their assets to survive.

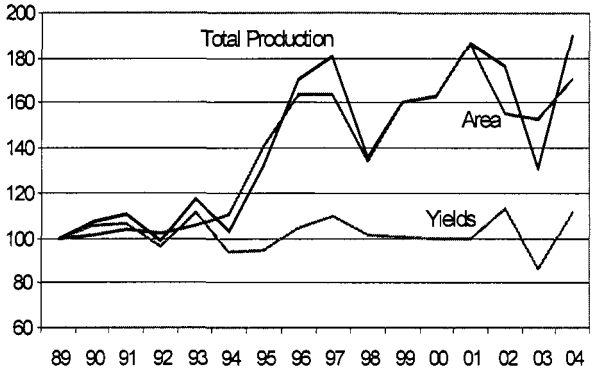
17. The Poverty Assessment also noted that the widespread acceptance by women themselves of violence against women epitomizes the deeply rooted existence of pronounced gender inequalities. For example, 60 percent of all women support female circumcision. The acceptance of domestic violence, and women's disempowerment more generally, not only has a striking impact on the well-being of women, it also appears highly correlated with other development outcomes. Women consistently have lower educational attainment than men, with over 75 percent of women having received no education at all (compared to 50 percent of men). Despite encouraging improvements, the gender gap in primary school enrolment remains significant. Children's chances of survival are highly correlated with maternal education and measures of empowerment.

III. THE DEVELOPMENT CHALLENGE

18. Good performance in recent years by the Government in implementing Ethiopia's Sustainable Development and Poverty Reduction Program (SDPRP) means that there is much to be lost if the country's progress on growth, poverty, and human development stalls or is reversed. The Government's commitment to poverty reduction has been evidenced by an increase in pro-poor spending from 39 percent of the budget in 1999/2000 to 54 percent in 2005/06, and the amount of tax revenue mobilized is one of the highest in Africa, relative to GDP. Moreover, Ethiopia has embarked on programs to improve the performance of its civil service while deepening its decentralized system in the context of improved fiduciary controls.

19. The Government's growth strategy, Agricultural Development Led Industrialization (ADLI), focuses on increasing agricultural productivity to raise the incomes of peasant farmer households. This, in turn, is expected to spark demand for industrial goods and therefore drive the development of the manufacturing sector, creating a virtuous circle. However, this circle has so far not been realized as expected: although there has been increased agricultural output, it has

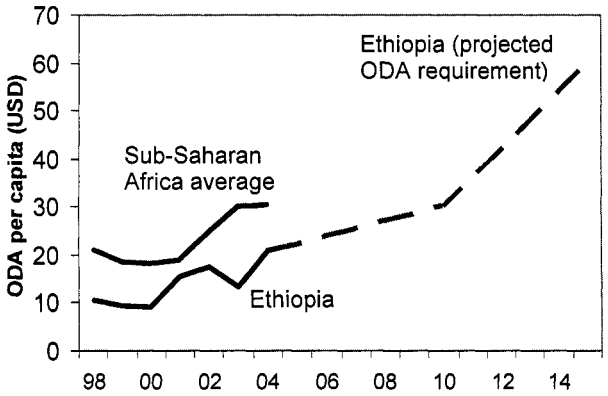
Figure 2: Productivity of Main Cereal Crops (Meher season, Indexed 1988/89 = 100)



been due to an expansion in area under cultivation and not through productivity improvements (see figure 2). Moreover, these supply increases have been insufficient to benefit consumers through lower real prices. Thus neither producers nor consumers have achieved the gains needed to sustain longer run growth, boost demand for industry, and spur structural transformation of the economy.

20. In the aftermath of the May 2005 elections, a key challenge for Ethiopia is to continue the progress made in recent years toward the Millennium Development Goals (MDGs). Progress will be constrained in the short term by the increased polarization of society and the absence of direct budget support and scaling-up of donor resources. To finance the increased spending needed to meet the MDGs, increased ODA is critical, since fiscal deficits and taxation are already high, even though Government expects high levels of growth. As shown in figure 3, Ethiopia's per capita development assistance is well below the sub-Saharan Africa average. Analysis conducted as part of the preparation of the draft PASDEP estimates that for Ethiopia to have a realistic opportunity to achieve the MDGs, donor support would need to rise from $20 to $30 per capita between now and 2010, and then about double by 2015 to reach $60 per capita, or $4.5 billion per year.

Figure 3: Ethiopia's ODA Requirement to Meet the MDGs



Note: Non-emergency aid only

21. Though strengthened governance will be needed to restore the upward trend in donor financing required to meet the MDGs. But more fundamentally, good governance is crucial to enable the effective delivery of services, promote peaceful and consensual resolution of conflict, and improve business confidence—without which, Ethiopia will not be able to make significant progress toward the MDGs. Even before the recent political developments, the Government, Bank, and donors were placing a strong emphasis on interventions to help strengthen key areas of economic governance—such as building institutional capacity for decentralization, supporting private sector growth, and improving transparency and accountability. But there is a broad consensus that the events following the May 2005 election require a deepened understanding of how political economy dynamics will shape the effectiveness of development interventions—particularly in relation to how political governance translates into the economic sphere.

A. Underlying Governance Dynamics and Implications for Reform

22. From a historical perspective, the political crisis surrounding the elections is not a new phenomenon in Ethiopia. Indeed, there have been recurring patterns of peaks and troughs on the opening and closing of political space since the current Government came to power in 1991. But the recent episode shows that the amplitude of the cycle has grown

to the largest size since the early 1990s. Some of this is an outcome of positive developments: increasing consolidation of vital aspects of democratization, including a vibrant opposition, development of private press, televised public debates, and growth of civil society. But the post-election period demonstrated that while institutions have begun to improve, they are still not strong enough to allow for peaceful and consensual resolution of conflicts, or to uphold property rights in the face of political turmoil.

23. Other societies and countries have also confronted such challenges, but have successfully addressed them through institutional mechanisms of sharing power and resolving conflicts. In Ethiopia, the way in which these deeper challenges and conflicts are playing out reflects: (i) evolving and weakly developed institutions for sharing power, debating policies and resolving conflict (an incomplete decentralization program, weak development of political parties, weak development of Parliament as a forum for multi-party policy debate, weak confidence in the judiciary, and concern about media capture); and (ii) a weak political tradition for accommodation and compromise (boycotts and violence instead of dialogue, and a tradition of winner-takes-all).

24. Looking forward, the current political crisis has revealed the necessity to make greater progress on an evolving but unfinished institutional reform agenda, within the framework of the Constitution. Historically an overly centralized state, Ethiopia is in midst of a state transformation process in which federalism—with power devolved to ethnically based Regions—has been the core part of the governance agenda. However, there is a still a long way to go in promoting differentiation across regions and localities, and accountability within regions and at the local level. The local elections constitutionally mandated to be held during 2006 will be a key test in this regard. There are many other aspects of unfinished institutional reform as well, particularly on horizontal accountability – strengthening the role of Parliament as an institutionalized arena for policy debate, an independent judiciary, a meritocratic public service, freedom for civil society and media openness. There is a broad agreement to tackle these weaknesses over time in order to rebuild trust between the state and citizens; indeed, efforts have started on Parliament, media, and the National Election Board.

25. There is also a significant unfinished agenda of transforming the political party system, with the biggest challenge being to separate political parties from the state. A critical priority is therefore to professionalize and insulate public administration to mitigate the risk that devolved funds and service delivery in the context of decentralization could be captured for political ends. It is also important to examine evidence of an "anti-private sector" ideology of middle bureaucracy, as well as re-examine the role of "party companies" as a source of party finance and their potential adverse impact on private sector investment. For opposition parties, the challenge is to compete based on a coherent policy agenda in institutionalized forums such as Parliament, but also reduce dependence on the diaspora which risks externalizing accountability. This calls for a review of electoral and party financing in Ethiopia, with a view to exploring the feasibility of public funding of political parties.

B. Centrality of the Governance Agenda for Development

26. The challenge of pro-poor growth includes the effective delivery of public services, fostering private sector development, and addressing massive gaps in Ethiopia's infrastructure. While there has been progress recently in these areas, especially in service delivery and in infrastructure, continued gains are contingent on the extent to which problems of political governance have the potential to adversely impact the development agenda. Strengthening governance reform and institutional capacity building efforts are therefore not only important in and of themselves, but also in order to make progress on the broader development agenda.

27. ***Governance and Service Delivery.*** Local governments have the main responsibility for primary service delivery, including education, health, agriculture extension, water, and local roads—as well as safety nets and food security. Since Ethiopia began decentralizing service delivery responsibilities—first to regions, in the mid-1990s, and then more recently to local governments—there have been important gains in recent years on human development indicators (table 2)—which will require improved local governance and increased accountability in order to be sustained.

Table 2: Selected Millennium Development Goal (MDG) Indicators

MDG Goal	Indicator	1990	2000	Current level	MDG target (2015)
Halve Income Poverty	Poverty Headcount Ratio (%)	46 (1996)	44	Pending (2005)	23
Achieve Universal Primary Education	Primary Gross Enrollment Rate (%)	32	61	79 (2005)	100
	Primary Completion Rate (%)	22 (1988)	29	37 (2004)	100
Promote Gender Equality	Ratio of Girls to Boys in Primary School	0.66	0.69	0.81 (2005)	1.00 (2005)
Reduce Child Mortality	Under-5 Child Mortality (per 1000)	204	166	123 (2005)	68
Halt the spread of HIV/AIDS	HIV prevalence (%)	NA	7.3*	4.4* (2003)	7.3
Halve the Number of People without Access to Clean Water	Access to Clean Water (%)	19	28	35.9 (2004)	63

** 2000 and 2003 surveys used different methodologies and are not statistically comparable.*
Source: World Bank, MOFED (SDPRP APR 2 and draft PASDEP)

28. In **education**, there has been rapid expansion in the access to primary education over the last eight years. Grade 1-4 enrollment grew at a rate of 10.6 percent per year between 1995/96 and 2003/04, and at a rate of 12.3 percent per annum for grades 1-10 overall. However, the fast expansion in primary school access has been accompanied by concerns over the quality of education—in terms of test achievement scores, pupil to teacher ratios, and completion rates. Government has been planning to increase shift some

of the financing burden for education to communities, but must be careful not to overburden poor communities' ability to contribute.

29. **Health** expenditures, at around one percent of GDP, are currently very low compared to both needs and comparator countries. Government has recently prepared its third Health Sector Development Program (HSDP III), which aims to at least double health expenditures. HSDPIII would be implemented mainly through the GoE's flagship Health Extension Program (HEP) which aims at dramatically expanding the provision of basic services by local governments, especially in rural areas. Among other areas, HSDP III implementation is expected to involve increased attention to prevention (nutrition) and population (family planning). While progress on some health indicators has been improving recently, execution of health activities often suffer from delays due to the lack of financing for drugs, equipment, and medical supplies and low capacity for procurement. This constraint is expected to be addressed through a MDG Performance Facility—supported by IDA through the Protection of Basic Services project—for critical health commodities that would reduce donor fragmentation, increase financing levels, provide performance incentives to districts (*woredas*), and maximize economies of scale in procurement.

30. Access to clean **water and sanitation** is vital for improved health and livelihoods. In 2000, about 16 million people had access to improved water supply, and 9 million to adequate sanitation. To achieve the MDG for water supply 40 million more people would need to be served by 2015. Even then, some 30 million people would be without service. A total investment of at least US$2 billion (US$200 million per year) is needed to achieve the MDG in Ethiopia, while current resources available—mostly from the Bank, AfDB, and the Treasury— amount to about half that amount. Despite the MDG financing gap, implementation of the Government's water and sanitation program is showing good results.

31. But while decentralization has given local authorities considerable responsibility for service delivery, they have few resources (only about $10 per capita, of which about $1 per capita for investment). **Being able to absorb the resources necessary to reach the MDGs in education, health, and water will require better local governance, increased empowerment of local authorities, and improved accountability to citizens.** In this regard, current risks relate to: possible capture of infrastructure investments and services at a local level; citizens being afraid to speak up and hold officials accountable in a politicized environment; and declining institutional capacity in the public sector stemming from dissatisfaction and low pay.

32. ***Governance and the private sector.*** Poverty reduction and progress towards the MDGs will only be possible if accompanied by a high and sustainable level of growth. This will require a rebound in business confidence, large investments in infrastructure, and continued progress on structural reforms, especially in the areas of urban and rural development, privatization, and financial markets. Even in the current political environment, these long-term structural reforms, and the build-up of infrastructure, should

not be abandoned given their importance for economic performance, and since there is broad support for them across the political spectrum.

33. The last several years have seen a number of improvements in the investment climate—in land, tax administration, and business registration procedures. However, Ethiopia is still in transition from a system in which the state was heavily involved in almost all production and distribution activities, and there remains a heavy influence of the state and political parties in the market. Key sectors which greatly influence the productivity of business – wholesale and retail trade, banking, communications and transportation – are closed to foreign investment or dominated by state firms. Firms, especially small and micro enterprises, have limited access to adequate transport services, information, education, and financial services, creating an inadequate base on which to build economic empowerment. The capacity of firms themselves is limited by their relative youth and lack of skills in comparison to firms in Ethiopia's competitors in the global marketplace. Where entrepreneurship exists it is small in scale and often non-innovative, as Ethiopian entrepreneurs are hesitant to go into nontraditional areas of production, which they perceive as too risky, typically investing instead in activities with low risks and low returns.

34. In the aftermath of the elections, it is plausible to imagine a prolonged period of uncertainty in which society and its institutions are highly polarized. This may create several adverse consequences for private sector development—particularly for small businesses that lack voice. There is a risk that enforcement of contractual and property rights become politicized. This may pose obstacles to the accumulation of social capital and trust both within the private sector, to the creation of an economy that is national in scope, and to realization of public-private partnerships that are essential to reach growth objectives. Polarization may stifle policy debate necessary to improve the policy framework itself. Finally, there is the possibility that continued tensions could dissuade increased FDI and private investment. All of these risks increase the need for strengthened institutions, such as the judiciary, to mediate conflict and to ensure that all firms irrespective of political affiliation are able to enforce their contractual and property rights, such that economic merit alone determines the rules of exchange and market outcomes. This will entail a strengthened agenda of enhancing transparency and governance for private sector growth (in addition to the ongoing focus on promoting free enterprise, removing binding investment climate constraints, and catalyzing growth through sector-specific partnerships).

35. ***Governance and infrastructure.*** Ethiopia's infrastructure investment needs are massive, and addressing them is imperative in order to promote growth and human development. Despite large gains in the last decade, Ethiopia's infrastructure endowment remains far short of that of other low and middle income countries, even controlling for income and other factors (see table 3). The recent Country Economic Memorandum indicates that international transport costs are much higher than average, meaning that only goods with a high ratio of value to weight—such as cut flowers—are viable exports at current transport costs. Moreover, lack of access to electricity constrains urban growth. Telecom penetration remains low, in spite of massive investments by the national

monopoly in recent years. Foreign direct investment in the telecom sector will likely be needed to enable faster growth in access to telecommunications.

Table 3: Ethiopia's infrastructure gap relative to income level

	Ethiopia's predicted levels	Ethiopia's actual levels	Ratio of predicted to actual
Road density (km per km^2 of land) [a]	0.14	0.03	5
Electricity consumption (kwh per capita) [b]	660	22	29

Notes: a. predicted road density from an OLS regression for low and middle income countries based on income level, population density, and arable and irrigated shares of land.
b. as above, but based on rural and urban population shares, surface area and incomes.

36. Given the drag on growth and poverty reduction presented by Ethiopia's infrastructure gap, continuing to focus on development of infrastructure should be a key priority of the country's development program. As Government's rebalancing of its growth strategy envisions, one way this can be done is by increasingly grouping complementary infrastructure around 'growth corridors' to boost returns. But as in any country, in order to achieve an adequate development payoff from infrastructure investments, care must be taken to ensure that the necessary procurement and financial management capacity is in place, and that the locations of the investments are chosen based on where they will be most productive. Productivity of infrastructure investments would also benefit from more dynamic national and regional debates on the priorities for infrastructure development.

37. The current situation does not necessarily mean a radical change in the long-term development prospects of the country. Rather, it has revealed underlying sources of weakness and fragility that have led both the government and donors to focus more strongly on good governance issues, which are essential for the sustainability of the development process.

IV. ETHIOPIA'S DEVELOPMENT STRATEGY

38. The Government is in the process of finalizing an ambitious new poverty strategy, called the Plan for Accelerated and Sustained Development to End Poverty (PASDEP). The strategy has been designed to accelerate the effort to reach the MDGs. It builds on the first poverty reduction strategy, the Sustainable Development and Poverty Reduction Program (SDPRP), and is innovative in several important respects.

39. PASDEP reflects a consensus that **pro-poor growth** is a fundamental priority. The program centers around a growth strategy for the next five years consisting of eight elements: (i) commercialization of agriculture and promoting much more rapid non-farm

private sector growth; (ii) geographical differentiation; (iii) population; (iv) gender; (v) infrastructure; (vi) risk management and vulnerability; (vii) scaling up service delivery to reach the MDGs; and (viii) employment. PASDEP advocates continuing to pursue the strategy of Agricultural Development Led Industrialization (ADLI), but with a more balanced approach to urban development, and with important enhancements to capture the private initiative of farmers and support the shifts to diversification and commercialization of agriculture. A private sector push, especially on exports, is advocated to create jobs and reduce foreign exchange constraints.

40. There is an important emphasis on good governance, with plans to accelerate local empowerment, and exploit regional differentiations. Decentralization, first to the Regional, and now to the district *(woreda)* and sub-district *(kebele)* levels, remains a centerpiece of Ethiopia's strategy both to improve responsiveness and flexibility in service delivery, increase local participation, and democratize decision-making. Policy reforms are expected to be enacted in a number of key domains during the PASDEP program, including revisions to civil and commercial law, human rights, sexual/gender harassment, and children's and HIV/AIDS-affected persons' rights. A justice sector capacity building program will aim to train and support the judiciary. The Human Rights Commission and Ombudsman's Office will both be strengthened as part of PASDEP, with the establishment of systems and procedures, and capacity-building and increased gender sensitivity. The emphasis on civil service reform and capacity building will continue, with a focus on strengthening staffing and incentives, and setting service standards for responsiveness to the public. There is also an increased emphasis on training of Parliamentarians.

V. MULTI-DONOR GOVERNANCE APPROACH

41. PASDEP's attention to addressing long-term governance issues is welcomed, but it needs to be developed further in the near future. In this regard, Ethiopia's development partners—including the World Bank—have agreed with Government on a framework for dialogue on issues of governance, including civil service reform and public sector capacity building; financial management; human rights and conflict prevention; democratic representation; access to information; the justice system; decentralization; and civil society participation. Among development partners, bilateral donors are expected to take the lead on the more overtly political elements of the dialogue.

42. The members of the Development Assistance Group (DAG) met in Paris in March 2006 to identify a set of shared principles to guide donor engagement in Ethiopia, particularly in regard to governance. All DAG partners indicated their wish to remain engaged in a long-term development partnership to support progress toward the MDGs. While the partners agreed that PASDEP is central to achieving the MDGs and more rapid economic growth, partners noted that their endorsement of PASDEP, and mobilization of sustained financial support, will depend on Ethiopia's progress on governance.

43. DAG members noted that the dialogue with Government on governance issues must be open, and should reach out to a wide group of Ethiopian stakeholders including

civil society and the private sector in order to begin to rebuild trust. In terms of modalities for DAG members to deepen support for governance, partners noted the need to adapt the mix of aid instruments to enhance predictability while aligning with Government systems to support areas such as basic services, public sector management and institutional capacity building, food security, and infrastructure. The meeting noted the importance of moving ahead quickly with the Protection of Basic Services (PBS) project (see paragraph 55) in order to protect pro-poor service delivery and enhance accountability.

VI. PLANNED SUPPORT PROGRAM

A. Strategic Objective of the ICAS

44. The strategy sees both *good governance and growth* as the central underpinnings of the Bank's support to Ethiopia.[2] It uses both of these as filters through which to evaluate each of the Bank's current and planned interventions. The ICAS reflects the expected thrust of the PASDEP, currently under preparation, and seeks continued dialogue with Government, civil society, and donors on strengthening existing governance and institutional capacity building programs.

45. **As part of the multi-donor effort, the Bank's overarching objective will be to support Government in developing and implementing, in consultation with citizens, a strengthened program of institution building and governance reform that will help in its efforts to accelerate pro-poor growth.** To achieve this objective, the Bank will deepen support in ways that strengthen good governance and accelerate growth in the following areas: (i) "core" governance—public administration, decentralization, and public financial management; (ii) the provision of basic services in a fair and accountable way, (iii) the promotion of free enterprise, (iv) improved agricultural productivity; and (v) the development of infrastructure to nurture the growth of small towns and growth corridors.

46. Achieving this multi-faceted objective will not be easy, as it can only be achieved with full government ownership, as well as a level of consensus in a polarized society. Still, the strategy recognizes that building good governance is a long term effort. Consequently, the Bank must be prepared for the peaks and valleys that may accompany the implementation of this strategy, and be able to adapt levels and modes of support accordingly.

B. Lessons from the Last CAS

47. A review of the implementation performance of the FY03-05 CAS concludes that—while the improvements in the FY03-05 period were very much led by the client—IDA's support under the CAS was instrumental in enabling the country's good

[2] The ICAS builds on the findings of a World Bank governance mission that visited Ethiopia in January 2006, as well as other ESW on growth and service delivery, to analyze recent developments in political governance, diagnose the risks they may pose for economic development, and suggest key implications for the Bank's strategy in Ethiopia.

performance in implementing the SDPRP. Though the CAS was not prepared as a results-based pilot, it included a set of monitoring indicators, and positive movement has been observed on almost all indicators where data is available. CAS objectives were mostly accomplished, though debt sustainability concerns, a shortage of IDA13 funds, and slower than expected progress in certain areas—such as on the rural growth agenda—limited the delivery of the Bank's assistance to some degree. At same time, dialogue has improved in some areas that had not been targeted by the CAS—such as urban development, agriculture, finance, telecoms, and public-private partnerships.

48. The review highlights a number of lessons learned during the FY03-05 CAS, including the need to: (i) become more selective; (ii) accelerate efforts to harmonize assistance and shift support to lower transaction-cost instruments; (iii) consider carefully the desirability of certain instrument types, such as LILs, which have not performed as well as expected; (v) continue to increase decentralization of senior staff; and (vi) strengthen the Bank's communications strategy.

49. *QAG Evaluation of Country Program.* Prior to the May 2005 election, the Bank's independent Quality Assurance Group (QAG) conducted a Country Program Assessment (CPA) assessing all Bank work in Ethiopia during 2003-2005, the period covered by the last CAS. The QAG Panel found the Ethiopia Country Program during FY03-05 to be satisfactory in all key aspects: responsiveness to government plans and needs, strategic relevance of analytical efforts and lending interventions, coordination with other donors, the design and quality of tasks, implementation and likely impact.[3] The panel suggested that there was a need for a better balance between growth acceleration and direct poverty reduction efforts in both the government's and Bank's program, especially in agriculture. In addition to agriculture, the CPA recommended further reforms in private sector development and public expenditure management. The QAG panel suggested that the planned scaling up of ODA and IDA allocations to Ethiopia should be conditional upon demonstrated success in these areas. This last recommendation, while having been superseded in the short-term by political events, will still be relevant in the case of an eventual return to a scaling-up scenario.

C. Elements of the ICAS

(i) Deepening Ethiopia's 'core' governance program

50. Given that the Government's strengthened governance reform program is not yet fully defined, the Bank and donors will need to adopt an "adaptive" approach. Still, within the multi donor governance approach, the Bank should play a leading role in supporting governance in areas consistent with the Bank's mandate—particularly in "core" areas such as public sector reform, decentralization, public financial management, and local-level

[3] The CPA noted that the program would have been rated even higher but for the following factors: relative insufficiency of ESW on economy wide issues (a CEM and Poverty Assessment have since been completed); many lending initiatives were new and their impact on growth acceleration and poverty reduction not firmly established; and the dialogue on policy issues was steadily improving but there was room for improvement on the strategy for private sector development.

accountability and empowerment. While the Bank as an institution has a strong comparative advantage in these areas, the skills within the country team will need to be upgraded, particularly through the relocation of governance expertise to the country office. The Bank will rely heavily on bilateral partners to lead on human rights and political governance.

51. Improving existing instruments for supporting governance and institutional capacity building will be central to the multi-donor approach. For the last year and a half, the Bank and several donor partners have concentrated their support for the governance agenda around the **Public Sector Capacity Building Program (PSCAP)**, Government's main vehicle to improve the scale, efficiency, and responsiveness of public service delivery at the federal, regional, local level services, to empower citizens to participate more effectively in shaping their own development, and to promote good governance and accountability. Similarly, the **Capacity Building for Decentralized Service Delivery project (CBDSD)** aims to support institutional capacity building in towns.

52. The March 2005 PSCAP Joint Supervision Mission concluded that the project is functioning well in several key respects. Still, as confirmed by a recent Fiduciary Assessment and periodic Joint Budget and Aid Reviews, gaps remain in terms of delays in financial reporting, inadequate capacity of the auditor-general and weakness in legislative scrutiny of audited financial reports; and the adequacy and quality of procurement, and of budget reporting. To enhance the performance of the activities supported under PSCAP, the Bank, donor partners, and Government agreed to measures to strengthen meritocracy in public service, expand *woreda* benchmarking to allow improved tracking of local government performance, strengthen local-level consultation and redress mechanisms, and streamline the flow of capacity building funds to Regions, *woredas*, and federal Ministries.

53. In the context of the multi-donor governance dialogue, the Bank will use the ongoing **Institutional and Governance Review (IGR)** to help the Government define its medium-term reform program on governance, ascertain priorities for different components of the governance program, table more facts to inform the analysis and the dialogue, and identify gaps for further analysis.

54. The **World Bank Institute (WBI)** is expected to play an important role in supporting strengthened governance. In particular WBI support is envisaged to focus on Parliamentary capacity building, media training, and dialogue with the diaspora in order to bring needed investment and skills back to the country.

(ii) Providing basic services for poor people in a fair and accountable way

55. Ethiopia—which, unlike many other countries is heavily reliant on public, rather than private, service provision—has made important gains in recent years, especially on health and education indicators, and in the fight against chronic food insecurity. With the discontinuation of direct budget support from donors, the World Bank has an important stake in protecting the Government's planned expansion of basic services for the poor. At the same time, the Bank and donors will need to support Government in its commitment to

provide these services in a fair, transparent, and accountable manner—since increasing resource flows to local authorities will require adequate checks and balances to be in place to ensure effectiveness and accountability of service delivery.

56. A priority in the first year of the ICAS will be to protect the planned increase of federal to sub-national transfers to fund local service delivery and food security programs. The proposed **Protection of Basic Services (PBS)** investment operation will fund critical basic services for the poor at the sub-national government levels (regions, cities, and local authorities). The PBS operation will provide this support with greater reporting on the use of resources, and monitoring of the fairness of the transfers—to support Government's commitment to distribute resources for basic service delivery equitably, without regard to local political allegiances. The PBS will also support the development of demand- and supply-side accountability mechanisms that will be expected to scale-up during the course of the ICAS and beyond.

57. Though decentralization has given local authorities considerable responsibility for basic education and health, water, and local roads, they have few resources. The small budgets local governments do have are largely used for salaries, with little (about $1 per capita) remaining for capital spending. As a complement to the PBS series (which will largely fund the recurrent costs of service delivery), donors, Government, and the Bank are developing a new instrument to finance capital investments by local governments in a way that reduces transaction costs, promotes accountability, and enhances their ability to effectively utilize more resources. In support of this new local resource window, the Bank is preparing a **Local Investments Grants (LIG) project**, which would operate on a performance basis, while making allowances for poorer performing areas to improve governance and implementation capacity to required levels before receiving funds. The PBS operation would help build a solid foundation for the LIG (especially in regard to participation, accountability, and avoiding the risk of political capture).

58. The PBS and LIG operations will be the catalysts for integrating all Bank projects operating primarily at the regional and local levels (and possibly those of other partners as well) into a **framework for sub-national governance and service delivery**. The integrated framework will include PBS, LIG, the district-level decentralization program component of PSCAP, CBDSD, CBAS, as well as several CDD operations (Pastoralism, Food Security, Productive Safety Nets, Women in Development) that support empowerment, gender balance, and decentralized decision making processes to ensure that resources are allocated according to the priorities of poor people. This is especially important as these projects are central components of Government's strategy to combat **vulnerability**, and the quality of governance can be the difference, for example, between whether or not poor people can survive a drought with their health, livelihoods and assets intact.

59. Key elements of this integrated framework would be (a) **joint budget and aid reviews** which are participatory, in order to broaden awareness over how resource allocations are made; (b) strengthened *woreda* and *kebele* planning; (c) a diverse monitoring and evaluation program that promotes broad-based citizen reviews of

government performance and feedback into planning (integrating *woreda* benchmarking and citizen report cards); (d) improved internal and external accountability mechanisms to mitigate the risk that CDD resources could be captured by vested political interests at the local level; (e) increased harmonization across donor partner programs; (f) initiating debates between Government and civil society on the role of civil society in development (i.e. services, accountability, innovation, and M&E).

60. Improving **urban** governance and service delivery is a stronger priority in light of election results. This can involve strengthening municipal administration and finance in ways that promote greater participation and accountability in decision-making. Bank support will take note of the special considerations of municipal authorities, as local governments facing a unique set of challenges. The block grant system, which transfers funds from federal government to regions down to local governments on a formula basis, currently does not cover municipalities. Regions tend to transfer funds to municipalities on an ad hoc basis, often to mitigate crises. The LIG intends to put all sub-national governments (including those in urban areas), on an equal footing with performance-related access to both capacity building through PSCAP and equity-based grant financing for basic service delivery.

61. Making progress on this framework will be challenging, but the better understanding of local government service delivery that is expected to result will be critical in developing a local-level "effectiveness agenda." Such an agenda will aim to use the combined experience of the programs in the framework to identify and implement means to improve effectiveness of local service delivery by targeting implementation bottlenecks. The potential for **Information and Communications Technologies** (ICTs) to help improve the reach, effectiveness, and governance of service delivery will be explored through the ICT Assisted Development Project and in partnership with *info*Dev.

62. Development of the integrated framework will benefit from an **Action Learning Initiative for Local Governance and Service Delivery**, with the support of the Government of Japan. The initiative will build knowledge and experience in order to strengthen existing and emerging organizational mechanisms and processes through which citizens and government engage in planning, budgeting, accountability, service delivery and the implementation of local development initiatives at *kebele* and *woreda* level

(iii) Fostering free enterprise

63. The Government has made steady progress in improving the investment climate in recent years, including improving tax administration and lowering taxes on business, reforming urban land administration, and improving licensing and registration procedures. New, export-oriented industries such as horticulture are growing rapidly. Still, business confidence has eroded following the May election, and many constraints to private sector development remain—some related to governance, and others to the capacity constraints in the private sector itself. In this context, the World Bank will increase its efforts to support free enterprise, innovation, and entrepreneurship.

64. A key focus of the ICAS will be to strengthen institutions of governance of the private sector. The Bank will continue to review and seek to strengthen the effectiveness of the **privatization** process, and of the **competition** decision-making bodies. In parallel, the Bank will seek to improve governance within its own private sector development (PSD) programs (PSD Capacity Building, Information and Communication Technologies Assisted Development, Financial Sector Capacity Building), particularly through strengthening the private sector's role in oversight of funds and a meritocratic allocation of those resources.

65. The Bank can also help to **build space for the private sector, and enhance trust between the public and private sectors.** The Bank will support reinvigoration of public-private fora, leveraging best practices from Asia and Africa. The Bank will also seek to initiate dialogue on the role of party-owned companies, and would continue dialogue regarding the liberalization of telecom services in order to attract FDI and accelerate growth in access to telecommunications. Finally, the core governance agenda of strengthening checks and balances and rule of law should help create a credible and stable environment for FDI and domestic investment more broadly.

66. One needed expansion of support is the development of **governance diagnostic and monitoring scorecard.** The Bank has recently expanded the range of instruments available to support monitoring and assessment of country performance in the area of good governance. Drawing upon this recent work, the Bank is proposing to invest through periodic Investment Climate Assessments (ICAs) in a set of indicators to measure the extent to which the public policies, institutions and services which support the private sector are well governed and perceived to be managed fairly.

67. Looking at issues related to both capacity and investment climate, a series of **value chain analyses** will aim to identify short to medium term actions to increase trade and investment flows, based on an assessment of the key policy and logistical obstacles, coordination failures, capacity gaps, missing institutions and/or investment needs in several promising sectors, especially in high value agriculturally-based exports such as horticulture and leather.

68. A more transparent, well-governed, well-regulated, and competitive **financial sector**, which can allocate resources in a more effective and efficient manner, will be critical for the growth of the private sector. Ethiopia's financial sector is still in the early stages of its development, and important constraints remain that prevent the sector from making a fuller contribution to economic growth. Notable among these are: the weak capacity of the NBE to regulate and supervise the financial sector; under-developed financial sector infrastructure (e.g., absence of a modern payment system, deficiencies in the credit information system); lack of a diversified range of financial products, which has hampered access to finance by large segments of the economy; lack of openness to FDI; and the paucity of technical expertise and professional skills among financial sector staff, as well as inadequate in-country training facilities. A **Financial Sector Capacity Building** operation will combine reforms with capacity building and will be of critical importance in boosting private sector growth.

Box 1: Consultations—Building Support for the Strategy

In light of calls by some members of civil society for development partners to cut off aid to Ethiopia, a range of consultations were held to build broad support for the interim program. These consultations included meetings in February with the Government, civil society, the opposition, and donors, in January with the diaspora, and in December with the private sector.

The consultations revealed broad and strong support for putting good governance at the center of the Bank's strategy, the importance of providing critical support for services for poor people in ways that can avoid political capture at all levels, and the need to strengthen institutional capacity and investments in growth to prevent backtracking of the development effort.

The consultations also underlined the need for improved transparency of local-level data for the development of an effective results agenda on public services, the need for dialogue on the role of civil society in development, the centrality of the need to foster free enterprise, and the critical importance of rebuilding trust between the state and citizens. Consultations also brought to light the need for a new study on the distribution of growth corridors. It highlighted the value of engagement by donors in order to play an effective mediation role in bringing various actors to the table, and offering incentives for reconciliation.

In September through October 2005, Ethiopian stakeholders, including Ministers; State Ministers; Parliamentarians; Federal, Regional, and *woreda* government officials; bilateral and multilateral donors; private sector representatives; civil society representatives, journalists; academics; and members of the judiciary participated in a World Bank client survey. Results indicate that stakeholders in Ethiopia are more positive about the Bank than in neighboring and other comparable countries. For instance, 81 percent of respondents in Ethiopia believe that the Bank should be more involved in supporting development efforts than it is with its present level of support. The survey also pointed out that the Bank needs to strengthen its efforts to collaborate with other partners, particularly civil society organizations. Therefore, the Bank will continue to reach out to a broad range of stakeholders in Ethiopia to solicit their views on the country's development priorities.

(iv) Increasing agricultural productivity

69. As noted earlier, agricultural growth has been strong recently, but performance has been driven more by a rebound from drought and an expansion of land under cultivation, rather than increases in agricultural productivity. The core components of ADLI remain important in efforts to increase agricultural productivity, but the rebalanced strategy in PASDEP will include a more focused effort to boost the role of rural towns as growth centers and markets for goods and services, increase private sector participation in agriculture, strengthen of agricultural technology systems, and improve management of the environment and watersheds. Apart from the strategy itself, implementation of agreed initiatives must also improve, as several of the Government's own SDPRP performance indicators for rural development have not been met.

70. Progress in freeing up agricultural markets and reducing transactions costs has to date been hampered by centralized control of key markets (e.g., for fertilizer) and preference for quasi-official cooperatives. A greater focus on the private sector, incentives for FDI in agriculture, and competitive markets would improve the growth orientation, with the main priority in this regard being the need to build private seed and fertilizer

markets and develop small towns and growth corridors in rural areas as centers of activity and employment. Dialogue with Government on this agenda will continue in the ICAS period, as well as analytical work to help to build a shared vision of agricultural strategy.

71. Agricultural research and technology will be a key area of World Bank support. The **Capacity Building and Agricultural Services Project (CBAS)** will support agricultural research, enriched content in the agricultural training programs (TVET's and Farmer Training Centers), market information and analysis, and pilot efforts to demonstrate alternative models for delivery of extension services (including through the private sector and NGOs). The earlier intention for this project was to support the extension system more broadly. However, in response to concerns about the continued high degree of central control over extension services, the Bank has scaled back the support for extension in CBAS to the piloting and scaling up of innovative models of delivery. Also on the productivity agenda, a flagship **Rural Development Review**, near completion, is analyzing the factors affecting agricultural productivity and identifying an agenda of actions to contribute to productivity growth.

72. **Irrigation and drainage**, combined with watershed management, hydropower, roads to markets, and other infrastructure investments, has the potential to provide the incentives and opportunities for farmers to shift out of subsistence agriculture into surplus/commercial agriculture and non-agricultural activities. Support for irrigation development will be complimented by the proposed **Tana Beles Water Resources Development Project** which will aim to better manage water inflows into the lake, and to coordinate water management efforts with complementary investments in roads, electricity, telecommunications, and PSD.

73. Ethiopia faces numerous challenges in the area of land and **environmental** management which threaten its potential for sustainable agricultural growth. To achieve the double dividend of economic growth and sound environmental management, the Bank will assist Ethiopia to mainstream environmental issues into development programs. Land degradation is at the top of the environmental agenda in Ethiopia, and efforts to slow or reverse degradation are included in Energy projects (since electricity substitutes for biomass), the Productive Safety Nets projects, and the proposed Tana Growth Corridor project (watershed management). A proposed **Sustainable Land Management Project** (to be financed by the GEF) will be designed to improve farm productivity and maintain and/or restore the ecological integrity and functions of rural landscapes through the adoption of sustainable land management policies, practices, and technologies.

74. The Bank would also support capacity building efforts and investments to enable Ethiopia to earn revenues from the Kyoto-based carbon markets through the Clean Development Mechanism. Projects eligible to earn greenhouse gas emission reduction credits, such as the **Humbo Assisted Regeneration Project** (to be financed from the Bank's Carbon Finance operations), would result in improved local environmental conditions, the transfer of more efficient and cleaner technologies, and unique opportunities to generate income for the very poor in both urban and rural areas. The Bank

would also undertake a comprehensive assessment of the potential to scale-up the production of biofuels (ethanol and biodiesel) in Ethiopia.

(v) Developing infrastructure to support development of towns and growth corridors

75. Given the long-term nature of infrastructure development, and its importance for growth, the Bank's will continue its strong support for strengthening Ethiopia's infrastructure endowment, within a framework that supports the good governance of these investments. Given the country's resource constraints, focusing investments in high-potential areas (towns and growth corridors) can enhance the returns to overall GDP growth, as opposed to spreading infrastructure investments evenly across the country. Only about 16 percent of the population of Ethiopia currently lives in towns, but the urban population is increasing around twice the rate of that in rural areas. Government recognizes the growing importance of urban areas (including small rural towns) as markets for both labor and for agricultural products. These areas provide economies of scale (with regard to infrastructure and service provision) and benefits of agglomeration that are vital to accelerate rural growth via the reduction of transaction costs and increasing productivity.

76. To unlock the growth potential of small towns and high potential rural areas, major new investments in **energy** are required. At the Government's request, the Bank will make support to the energy sector a major component of its assistance during the ICAS period and beyond. However, the sustainability of EEPCO's cost structure will be a key consideration, especially considering the utility's ambitious electricity access expansion plans. The ambition of these plans is laudable, given the low access to electricity, especially in rural areas, but the pace of expansion should not exceed sustainable levels. In a positive first step, Government has recently approved a 22 percent increase in electricity tariff. Over time, additional increases are likely to be required, though these will be politically unpopular.

77. The Bank will also continue to support the development of the **roads** sector—also key for the development of towns and high-potential rural areas. Here, an increase in the cost of bitumen due to rising oil prices has doubled the unit costs of road construction. This will require prioritization of road investments, including consideration where appropriate of substituting gravel roads for paved roads, increasing decentralized decisions, and improving incentives for maintenance.

78. To address the special needs of urban areas for jobs and infrastructure, the Bank will also explore support for **urban development** programs such as urban land administration, urban housing, upgrading of informal settlements, water, etc., and development of mortgage markets that would let poor people improve their housing, provide employment, and open up new opportunities for private enterprise. Such interventions should be focused on Addis Ababa as well as other urban areas.

79. Addressing the distribution of infrastructure assets and the manner in which infrastructure is procured will be given high priority both in new and existing projects. A

study on growth corridors will help to identify sites for concentrated investment, with a focus on the economic return on such investments, and on ensuring fair distribution among the various regions.

Box 2: Regional cooperation

Multi-country infrastructure projects can build interdependencies among nations and thereby help promote regional stability. Numerous opportunities for win-win regional collaboration exist. The Nile Basin Initiative (NBI) has opened the possibility for Ethiopia to harness the waters of the Nile in new ways. By fostering cooperation among Nile riparians, the Initiative has made it possible for Ethiopia to embark on several promising new initiatives, which the Bank expects to support either in the ICAS period or afterward. Such initiatives include the Tana Growth Corridor project, a Sudan Power Interconnection project, and a Flood Control project.

The Bank will also undertake a study of infrastructure cooperation in the Horn of Africa, in the context of the IGAD Peace and Security Initiative. In addition, the Bank will prepare contingency plans to support the border demarcation with Eritrea in the event of a resolution of the dispute.

D. IFC and MIGA

80. The **International Finance Corporation (IFC)** has one investment in Ethiopia, as part of a regional project for Coca-Cola SABCO. There is interest in an increased role for IFC in trade facilitation, and IFC expects to scale up efforts to identify possible areas for new investment. Early candidates for potential investments include housing finance, horticulture, SMEs, stock market development, leasing finance, and private sector opportunities that may arise from the Nile Basin Initiative. The **Multilateral Investment Guarantee Agency (MIGA)** has played an important role in helping resolve expropriation claims dating from the Derg regime, and will start considering guarantee applications for investments into Ethiopia.

E. Modulating IDA Support

81. The annual Country Policy and Institutional Assessment (CPIA) provides a basis for modulating a country's IDA allocation according to performance on sixteen indicators measuring its policy and institutional framework. CPIA indicators on governance are given extra weight in the IDA allocation formula, so that progress or deterioration in governance is an important determinant of levels of IDA support. Ethiopia's IDA ceiling of $574 million in FY06 was based on the country's performance in the 2004 CPIA, as well as its portfolio performance, population, and per capita income—the other components of the IDA allocation formula. The 2005 CPIA rating for Ethiopia, just finalized, reflects a decline on indicators relating to governance, but improvements on non-governance areas, with the overall result that the rating is unchanged from 2004. Still, the heavy weight on governance in the IDA formula means that Ethiopia's FY07 IDA ceiling is likely to fall, though it has not yet been calculated.

82. Table 4 shows the indicative IDA lending program for FY06-07. The ICAS proposes a lending program for FY06 of $491 million, half of which will be available in the form of grants. The projected FY07 IDA envelope is a range: the upper boundary based on the ceiling given by the IDA allocation formula for FY07 plus the carry-over of unused IDA resources from FY06, and a lower bound (up to 30 percent reduction) reflecting a low case scenario. The low case scenario would be applicable if Government performance in implementing the plans and program detailed in PASDEP and this strategy deteriorates significantly, particularly with respect to governance. This would be evidenced by unsatisfactory performance in regard to a significant number of the indicators in the ICAS Results Framework in Annex 1—i.e., public expenditure management and financial accountability, civil service incentives, budget transparency, fairness and accountability in delivery of basic services, the investment climate (as measured by the ICA update), agricultural policies, and progress in implementation of infrastructure investments. In the event of slippage to a low case scenario, projects such as Local Investment Grants (LIG) would likely be delayed as they rely on suitable conditions being present at the local level. Ethiopia will also be eligible to receive half of its IDA allocation in the form of grants in FY07.

Table 4: Indicative IDA Pipeline, FY06-07

FY06		FY07	
Protection of Basic Services*	$215 m	Productive Safety Nets APL 2	
Roads APL 2 Supplemental	$87 m	Local Investment Grants	
Rural Electricity Access Expansion	$125 m	Multisectoral HIV/AIDS 2	
		Rural Electricity Access Expansion 2	
Financial Sector Capacity Building*	$15 m	Tana Beles Water Res. Mgmt.	
CB for Agricultural Services	$49 m	Irrigation and Drainage	
Total:	**$491 m**	Roads APL 3	
		Urban Development	
		Total:	**$400-550 m**

** IDA grant*

83. While debt relief received under MDRI will be deducted from Ethiopia's IDA allocation beginning in FY07, donors have agreed to provide IDA with additional financing over time to compensate for the loss of repayments as a result of MDRI. The compensatory resources will be redistributed across IDA countries based on performance, thereby ensuring additionality for Ethiopia, as well as other IDA countries.

84. Depending on circumstances, there are several other projects that may be appropriate for delivery in FY07 in addition to, or lieu of, the projects included in table 4. These include support for the concessioning of the Ethio-Djibouti Railway, an Avian Flu project, and Nile Basin Initiative projects, such as a Sudan Power Interconnection project and a Flood Control project (if Regional IDA funds are available). A GEF-financed Sustainable Land Management project is also under preparation.

85. In returning to a **longer-term CAS** program, the Bank will review the progress made on strengthening, building consensus on, and implementing an enhanced governance agenda. Particular attention will be given to those areas where the Bank's involvement is strongest, e.g. those included in the ICAS Results Framework in Annex 1. If progress is adequate, a new three-year CAS, including a possible resumption of budget support through the PRSC instrument, could be envisioned as soon as the beginning of FY08. Otherwise, the Bank would continue with a series of interim strategies or strategy updates.

F. Analytical and Advisory Activities (AAA)

86. In recent years, the depth and breadth of Bank analytical work has increased sharply. All core diagnostic reports—CEM, Poverty Assessment, Fiduciary Assessment, Joint Budget and Aid Review (JBAR)—have been updated recently. The good quality of the analytical program was confirmed by the recent QAG Country AAA assessment.

87. The Ethiopian context calls for a substantial investment in analytical and advisory services to have widespread impact on governance and to leverage the Bank's convening power. Key studies and reports that will be undertaken during the ICAS period include the Institutional and Governance Review, the Joint Budget and Aid Review (JBAR), an Investment Climate Assessment survey update, Civil Society dialogue, a study on Decentralized Service Delivery, a Rural PER, and a new Country Economic Memorandum on Governance and Growth that will update the recently completed CEM. Of these, the JBAR is particularly notable for its increased scope starting this year, when quarterly reviews will underpin efforts to increase transparency, participation, and accountability under the PBS. A comprehensive list of AAA is presented in Annex 10.

88. If Ethiopia's performance were to decline dramatically, the Bank would curtail lending in favor of an enhanced role for AAA and multi-donor dialogue. In this scenario, AAA would focus on protecting the existing portfolio, monitoring the status of service delivery and poverty-related developments, and remaining prepared to reengage in the event of a return to an improved environment for development.

VII. IMPLEMENTING THE PROGRAM

A. Measuring Results

89. Monitoring of the impact of ICAS interventions will rely on strengthening existing government mechanisms for data collection around the SDPRP and PASDEP, as well as outcome and output indicators available in the Bank portfolio of projects and analytic work. While the ICAS period is short, and consequently it will be impractical to expect major outcomes from projects initiated under the strategy (with the exception of PBS), Annex 1 contains an ICAS Results Framework that details the expected progress on achieving outcomes based on already active projects. The results framework also includes more process-oriented indicators relating to the expected progress towards the objective of

the ICAS, i.e. supporting Government in developing, achieving consensus with citizens on, and implementing a strengthened program of institution building and governance reform.

90. The Government and its partners are taking advantage of the opportunity provided by the preparation of PASDEP to refine the Government's monitoring and evaluation framework to make it a simpler and more effective framework for measuring implementation progress, around which partners can increasingly harmonize their own monitoring systems. This effort is taking place in the context of Government's "Strengthening SDPRP Monitoring and Evaluation Action Plan." Elements of the plan include hiring and training staff in the relevant MOFED units, increasing participatory aspects of monitoring and evaluation (initially through a Participatory Poverty Assessment), creating an Integrated Management Information System at the Welfare Monitoring Unit in MOFED, strengthening statistical capacity in the Central Statistical Authority (CSA) including establishment of a Socio-Economic Database, strengthening the results framework of the PRS, and improving reporting on PRS indicators in APRs. The Bank (through an Institutional Development Fund Grant) and other donors—including the United Kingdom, Ireland, Canada, UNDP, and the EU—have committed resources to support the plan.

B. Donor Harmonization

91. The Bank and donor partners, in collaboration with the Government, have made significant in progress in the harmonization process. Local development partners are finalizing an "Addis Agreement," a locally tailored version of the Paris Agreement with measurable indicators. In addition, the Bank has jointly developed an MOU deepening harmonization with the European Union, has agreed on a joint action plan with AfDB, and is considering similar agreements with DFID.

92. The Development Assistance Group (DAG), co-chaired by the Bank, has evolved from being a forum for information sharing towards a donor community speaking with one voice in the partnership with Government of Ethiopia, producing joint statements and policy notes with greater impact. This aspect of the DAG has proven highly valuable in the context of the events following the May election, as DAG members reacted in a closely coordinated manner. This tradition of collaboration will need to be utilized, and continuously reinforced, in the pursuit of the multi-donor governance approach described earlier in this document.

93. The World Bank has taken the lead on developing a diversified but focused set of instruments to reduce transactions costs, align support with the country's decentralized model, and enhance the predictability of aid. New approaches leveraging other donor contributions included PSCAP and Productive Safety Nets in the last CAS, and include Protection of Basic Services, Local Infrastructure Grants, and growth corridors in the ICAS. For more traditional projects, such as roads, action plans are being implemented to harmonize implementation procedures (e.g. common environmental assessment procedures) with a focus on three priorities – disbursement procedures and financial reporting, monitoring and evaluation, and procurement (starting with standard documents

for goods, works, and consulting services for national competitive bidding). Building on recent trends, increasing numbers of missions will be joint, and analytical reports are expected to be produced in collaboration with others partners.

C. Portfolio Management

94. As of April 21, 2006, Ethiopia's portfolio of IDA operations comprised 22 active projects, with total net commitments of $1,614 million and an undisbursed balance of $874 million. This compares with 18 projects, commitments of $1,795 million, and an undisbursed amount of $835 million in March, 2003 when the last CAS was discussed by the Board. Total disbursements to Ethiopia amounted to $373 million (of which $195 million of grants) in FY05, compared to $422 million ($179 million in grants) in FY04 as compared to $362 million (with no grants) in FY03. While short, the ICAS period will see the closing of a large number of projects (11 by the end of FY07).

95. The overall performance of the Ethiopia portfolio has been comparable to or better than Africa Region and Bank-wide performance in three key categories—problem projects, commitments at risk, and proactivity (Table 5). Two projects out of the 22 active projects (or 9 percent) are currently rated as a problem project (i.e. rated unsatisfactory for Development Objectives and/or Implementation Progress). This compares favorably with the Africa Region and the Bank as a whole where 15 and 11 percent of projects, respectively, are rated unsatisfactory. While Ethiopia has more favorable levels of both problem projects and commitments at risk than the Africa Region as a whole, its realism rating is lower than average due to the small number of problem projects relative to the number of projects at risk (problem projects *plus* those with 3 or more "risk flags"). In order to improve the performance on realism, the country team is examining those projects with 3 or more risk flags to address promptly the root causes of the flags if possible, and if not, to downgrade projects to problem project status. For all projects, the country team is working closely with Government in implementing action plans identified in the most recent CPPR.

Table 5: Ethiopia Portfolio Performance
April 21, 2006

	Ethiopia	Africa Region	World Bank
Number of Projects	22	337	1,326
Net Commitment ($ million)	1,614	17,102	91,900
Problem projects (number)	2	51	142
Problem projects (%)	9	15	11
Projects at risk (number)	5	82	213
Projects at risk (%)	23	24	16
Commitment at risk ($ million)	228	3,707	13,982
Commitment at risk (%)	14	22	15
Realism (%) *	40	62	67
Proactivity (%) *	75	74	79

* Realism index: The ratio of actual problem projects to total projects at risk.
** Proactivity index: The proportion of projects rated as actual problem projects twelve month earlier that have been upgraded, restructured, suspended, closed partially or fully cancelled.

96. The disbursement ratio for non-adjustment operations decreased modestly in FY05—to 25 percent, compared to 28 percent in both FY03 and FY04. Signs point to continued lower than trend disbursement levels so far in FY06. This is a result of the relatively slow-starting community-driven development type of projects and projects whose management is decentralized to the *woreda* level that have begun to represent a larger share of the portfolio. Such projects have encountered flow of funds issues relating to the low capacity at decentralized levels of government. To address the emerging trend of slower disbursements in the short-term, the country team will conduct a review of the slow-disbursing projects in the portfolio with the intention of restructuring projects where appropriate, and identifying other measures to accelerate disbursements. Over the longer-term, the PSCAP agenda of building institutional capacity at the decentralized level should help to address the more fundamental aspects of the capacity problem.

97. Efforts to improve implementation of the portfolio focus on both on the role of the Bank and of the Government, as well as the linkages to donors' programs. A top priority will be to address the issue of overdue audits for Bank projects. The current audit backlog is a result of insufficient manpower in the Office of the Federal Auditor General (OFAG) and the Audit Services Corporation, combined with increasing decentralization and the attendant difficulties in compiling financial information from over 600 often remote *woredas*. Government has produced an action plan for clearing the audit backlog, and the Bank and donors are discussing with Government ways to reduce audit capacity constraints. In addition, several other priority areas have been identified where implementation can be improved, including: (i) strengthening country systems rather than establishing parallel project management units; (ii) improving capacity to monitor results, especially with a view towards shortening "feedback loops;" (iii) consolidating World Bank staff decentralization; and (iv) improving communications on Bank activities.

98. A project-by-project review of the current portfolio has been undertaken to ensure that projects are not at risk of political capture, and to examine the ways in which governance risks may have a direct impact on project implementation. Possible risks identified included: the risk of political bias in the allocation of existing CDD assistance to local-level beneficiaries; the possibility of bias in the location and prioritization of infrastructure; the risk of unfair handling of bids due to lack of transparency in bid evaluation process; and the possibility that commissions dealing with private sector issues may not contain broad enough representation of private sector interests.

D. Country Financing Parameters

99. The Bank established country financing parameters for Ethiopia on February 8, 2006 which provide the overall framework for cost sharing arrangements, and the financing of recurrent and local costs, and taxes and duties, for all projects (see Annex 2). In line with new policy framework approved by Executive Directors on April 13, 2004 governing the eligibility of expenditures in World Bank financing, the financing parameters for Ethiopia make development objectives the primary determinant of Bank financing, while making sure that risks, such as those to fiscal sustainability and the use of Bank funds, are appropriately addressed. As such, the parameters—based on individual

project circumstances—allow the Bank to finance up to 100 percent of the cost of a project (though the average is expected to remain around the previous standard of 90 percent); set no limit on the level of recurrent costs the Bank may finance (subject to sustainability criteria); allow financing of local costs in any proportions required by individual projects; and permit the Bank to finance taxes and duties as long as they do not constitute an unreasonable share of project costs.

E. Managing Risks

100. The program will need to focus centrally on the key risks that might threaten to reduce the effectiveness of Bank support. The events following the May 15 elections underscore the importance of basing Bank support on a careful understanding and management of political economy risks, seeking firmly to address core governance challenges jointly with donor partners.

101. Going forward, three scenarios are possible, depending upon how the underlying political conflicts evolve:

- Significant negative developments with regard to governance, with an unraveling of the social compact and open conflict with one or more opposition groups or with Eritrea. This will continue to exacerbate both risks of increased uncertainty and violence, and greater risks to eroding institutions.
- Maintenance of the status quo, where the Government and opposition follow the present trajectory without any major unraveling or success in finding room for compromise. This will continue to pose uncertainty, with periodic or sustained violence and possibly further polarization over time.
- Progress and increased consensus on key governance issues, with major pacts/agreements between EPRDF and the opposition. This would re-establish security, stability and predictability for development, and create a conducive environment for institutional strengthening.

102. The first two scenarios pose key risks for economic development, including:

- Continued uncertainty, conflict, violence and concerns about human rights emerging from the immediate political conflict. This can continue to threaten or reduce aid, restrict investment, and put strains on the credibility and legitimacy of the state.
- Weak and eroding institutional checks and balances, raising the risk of capture of decentralization, block grants and the civil service, alongside a lack of level playing field or credible environment to attract private investment for growth.

103. If the future evolution of the political context causes these risks to become heightened, the Bank will seek to adjust its support accordingly, both to help the country address the risks, and to manage the level of resources entering an environment that may not be conducive to development.

104. Efforts to manage, and avoid, these risks will be an integral part of Bank assistance. Indeed, the primary focus of the multi-donor governance support program described in this strategy will be to address frontally the main risks faced by Ethiopia at this critical juncture. The Bank will need to rely on the efforts of bilateral partners to take the lead on the more overtly political concerns. A coherent front on the part of development partners will be crucial, and the risk of fragmentation among donors will need to be mitigated by a clear, fully-owned medium-term governance plan on the part of Government, as well as close and continuous dialogue between partners both at the country and leadership levels. Consultations with all actors, including the opposition, will be important to garner broad support for any Bank/donor program. An effective communications strategy will also be needed to convey the Bank's strategy to all stakeholders.

105. Apart from governance, other risks relate to the types of exogenous shocks to which Ethiopia has long been vulnerable—typically weather shocks and external economic shocks. The Bank is seeking to mitigate the impact of drought on development through its support to the Safety Nets, Food Security, agriculture, and environmental programs. On the macroeconomic side, the last JBAR revealed that Government expenditures have been following a pro-cyclical pattern. Given Ethiopia's susceptibility to shocks, the development of a more counter-cyclical fiscal policy will be important in smoothing the macroeconomic impact of such shocks; the Bank will assist Government in developing such a policy. A new type of exogenous shock is presented by the possibility of an outbreak of Avian Flu. The Bank is proceeding with preparation of a contingency project to support efforts to contain Avian Flu, should such a project prove necessary.

106. From year to year, the CPIA provides a mechanism by which the Bank can adjust its support to positive or negative developments in governance and other key aspects of the development effort. In the case of a severe deterioration in the governance context in Ethiopia, the Bank would reduce new lending and rely more on non-lending support. On the other hand, some of the shorter-term political tensions have the potential to be resolved quickly if the actors see sufficient incentives to compromise and dialogue constructively. In this case, and if the agenda of dealing with longer-term governance issues makes solid progress, the interim program would need to be rapidly enlarged to show an immediate dividend to the enhanced political stability, with a resumption of budget support and a speedy transition to a new full-fledged CAS.

Annex 1:
ICAS Results Framework

ICAS Strategic Objectives	Longer-term outcomes to which the ICAS is expected to contribute	Shorter-term outputs expected to result from the ICAS program
Overarching Objective: Developing, achieving consensus with citizens on, and implementing a strengthened program of institution building and governance reform with the goal of accelerating pro-poor growth.	Macroeconomic stability, and accelerated and less volatile pro-poor economic growth.	Building on existing initiatives, Government has developed, consulted with civil society (including the private sector), and begun to make progress in implementing a strengthened program of institution building and governance reform. Government has taken adjustment measures to remove the subsidy on fuel prices and bring electricity tariffs to sustainable levels, with complementary actions to mitigate the impact on poor people.
Deepening Ethiopia's 'Core' Governance Program	Improved public expenditure management and financial accountability, as evidenced by an increase in the number of PEFA indicators met	Strong implementation of recent agreements under PSCAP to enhance meritocracy in public service, expand *woreda* benchmarking to allow improved tracking of local government performance, and strengthen local-level consultation and redress mechanisms Consolidation of federal and regional budgets, including all extra-budgetary accounts Agreement between Government, the World Bank, and donors on plans for implementation of an integrated financial management information system (IFMIS) to facilitate federal and regional budgeting processes, strengthen public sector financial management, and improve fiduciary oversight.
	Improved income and non-income incentive environment for public servants measured by a gender disaggregated wage decompression ratios and private/public comparators, and broader implementation of new methods of performance evaluation.	New federal remuneration policy in place Increased number of ministries, agencies, and bureaus restructured and having adopted performance policy
	Citizens are better informed on public budget processes (budget formulation, allocation and expenditures.) Increased beneficiary satisfaction with local government services, as measured by *woreda* benchmarking surveys	Increased number of Regions and *woredas* that disclose public budget information at Regional, *woreda* and sub-*woreda* level. Increased number of basic Service Providers disclosing facility budget and resource information and performance indicators in facilities for public consumption and comment.

ICAS Strategic Objectives	Longer-term outcomes to which the ICAS is expected to contribute	Shorter-term outputs expected to result from the ICAS program
Providing basic services for poor people in a fair and accountable way	Access to basic services maintained at the same or higher levels as measured by expenditures on front-line services and use of services	Intergovernmental transfers reach intended recipients (regions and *woredas*) according to agreed distributional formula
	Increased percentage of children under 5-years of age who sleep under an insecticide treated bednets	Increased number of bednets distributed
	Increased proportion of children under 1-year of age vaccinated with DPT3 and measles vaccine	Increased number of doses of vaccine procured
	Increased contraceptive prevalence rate	Increased percentage of facilities without stockouts of injectable contraceptives in the last 3-months
	Improved food security and resilience to shocks for chronically food insecure households	All chronically food insecure households covered under a multi-annual predictable safety net Livelihoods of chronically food insecure households strengthened as reflected in improved productive asset base
Enhancing the investment climate and raising investor confidence	Improved investment climate, as measured by annual Investment Climate Assessment surveys	Legal and judicial reform program established with a focus on Code of Civil Procedure. Competition policy under effective implementation Simplified and faster business registration and licensing processes Reduction in number of steps required to obtain and register land lease
	Increased capacity of private sector firms	Increased number of firms applying for and receiving grants for business development services. Increased share of enterprises with audited financial statements
	Increased financing of private sector, as measured by total credit outstanding to the private sector as percent of GDP	Introduction of new financial products that are better tailored to borrowers' needs and can help lower the risks and costs faced by both borrowers and lender

ICAS Strategic Objectives	Longer-term outcomes to which the ICAS is expected to contribute	Shorter-term outputs expected to result from the ICAS program
Increasing agricultural productivity	Increased adoption of productivity-enhancing technologies by farmers	Increased capacity for agricultural research in the Ethiopian Agricultural Research Organization (EARO) and universities Agreement on pilot initiatives to explore alternative institutional arrangements for delivery of extension services (private sector, NGOs)
Developing infrastructure to support development of towns and growth corridors	Increased public satisfaction with infrastructure service delivery in urban areas as measured in citizen surveys	More spending per capita on local infrastructure and services by urban local governments Participatory planning and budgeting adopted in an increased number of urban local governments
	Reduced road transport costs per km	Increased number of km of federal trunk, link and regional roads upgraded or constructed Agreement on a work plan for scaling up of community roads in place
	Increased teledensity	Increased number of rural communities with access to telephones, in a cost-effective manner
	Increased access to clean water	Increased number of people covered by new or rehabilitated water supply schemes in urban and rural areas
	Increased access to electricity	Increased number of rural towns electrified

Annex 2
Ethiopia: Country Financing Parameters

Item	Parameter	Remarks/Explanation
Cost Sharing Limit on the proportion of individual project costs that the Bank may finance	Up to 100%	The actual financing share will be determined during the preparation of each new project, and will typically be around 90% of total project costs. Bank financing up to 100% will apply selectively to individual projects, on a case-by-case merit/justification basis, including operations supporting reform efforts and addressing most basic human development needs, including but not necessarily limited to food security and safety nets, health, education, rural water supply, and HIV/AIDS. Higher than average share of Bank financing could be applied to specific CDD projects, IDF grants, and others where the in-kind contribution by beneficiaries is difficult to measure. The strong emphasis on borrower ownership to individual projects will continue.
Recurrent Cost Financing Any limits that would apply to the overall amount of recurrent expenditures that the Bank may finance	No country-level limit.	In determining Bank financing of recurrent costs in individual projects, the Bank will take into account sustainability issues at the sector and project levels, including implied future budgetary outlays. The approach to recurrent cost financing will be the following. First, project costing in the PAD will specifically include estimates of recurrent costs implications, and will outline what are the plans to phase out Bank financing of recurrent costs, and phase in Government's absorption of these costs, when the project is finished. In sectors where a tax/user-fee arrangement is considered essential for sustainability (e.g., roads), the Bank will also take this into account in determining appropriateness and level of recurrent cost financing. Second, the project will include a brief explanation of the relative share of recurrent costs, per year, compared to the most recent recurrent expenditure information for the sector where the project will be located. Third, the aggregate of recurrent costs estimated in the whole portfolio will be examined within the context of the overall composition of public expenditure, during the annual review of the national budget. This examination will focus on fiscal sustainability issues, and the schedule of progressively integrating the share of Bank financing of recurrent costs into the MEFF to show how Government will absorb these costs (implied future budgetary outlays), as Bank

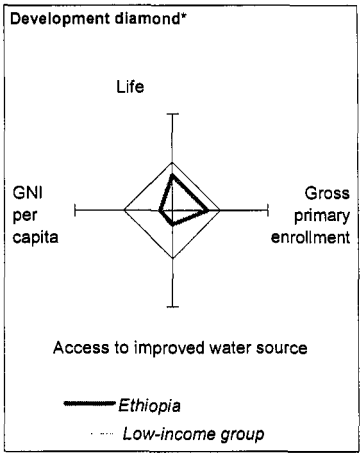
		financed projects reach completion. The Bank will continue to monitor the overall fiscal and debt situation, in coordination with the IMF, and as part of the institutional processes around the PRSP (APR-JSAN, JBAR, PRSCs, and country strategies).
Local Cost Financing Are the requirements for Bank financing of local expenditures met, namely that: (i) financing requirements for the country's development program would exceed the public sector's own resources (e.g., from taxation and other revenues) and expected domestic borrowing; and (ii) the financing of foreign expenditures alone would not enable the Bank to assist in the financing of individual projects?	Yes	Ethiopia meets the two requirements for local cost financing. The Bank can finance local costs in any proportions required by individual projects.
Taxes and Duties Are there any taxes and duties that the Bank would not finance?	None	The Bank may finance the costs of taxes and duties associated with project expenditures, as there are currently no taxes that are deemed to be unreasonable or discriminatory. The final decision, however, will rest at the project level, when the project team assesses whether taxes and duties specific to the project activities financed constitute an excessively high share of project costs. In individual projects, the project team will also review the incidence of excise tax on imported vehicles (which is considered high); such excise tax would be excluded from Bank financing in projects where imported vehicles constitute a material share of project costs.

Annex 3:

Ethiopia at a glance

4/6/06

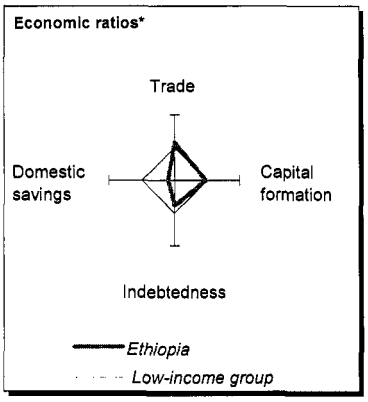
POVERTY and SOCIAL	Ethiopia	Sub-Saharan Africa	Low-income
2004			
Population, mid-year *(millions)*	70.0	719	2,338
GNI per capita *(Atlas method, US$)*	130	600	510
GNI *(Atlas method, US$ billions)*	9.3	432	1,184
Average annual growth, 1998-04			
Population *(%)*	2.2	2.2	1.8
Labor force *(%)*	2.0	1.0	2.1
Most recent estimate (latest year available, 1998-04)			
Poverty *(% of population below national poverty line)*	44	..	..
Urban population *(% of total population)*	17	37	31
Life expectancy at birth *(years)*	42	46	58
Infant mortality *(per 1,000 live births)*	112	101	79
Child malnutrition *(% of children under 5)*	37	..	44
Access to an improved water source *(% of population)*	22	58	75
Literacy *(% of population age 15+)*	44	65	61
Gross primary enrollment *(% of school-age population)*	68	95	94
Male	77	102	101
Female	59	88	88



KEY ECONOMIC RATIOS and LONG-TERM TRENDS

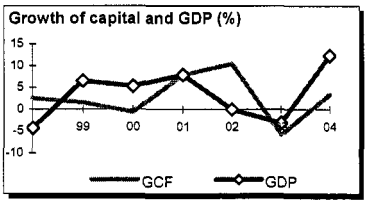
	1984	1994	2003	2004
GDP *(US$ billions)*	8.0	6.9	7.9	9.7
Gross capital formation/GDP	17.8	16.4	22.7	21.3
Exports of goods and services/GDP	7.6	7.1	14.3	15.4
Gross domestic savings/GDP	11.5	9.4	7.5	4.1
Gross national savings/GDP	13.1	16.0	20.5	16.1
Current account balance/GDP	-4.7	-1.3	-2.2	-5.1
Interest payments/GDP	0.6	0.6	0.6	0.5
Total debt/GDP	52.5	146.4	90.5	67.5
Total debt service/exports	20.4	19.8	7.6	7.7
Present value of debt/GDP	..	..	19.5	14.9
Present value of debt/exports	..	..	128.9	87.7

	1984-94	1994-04	2003	2004	2004-08
(average annual growth)					
GDP (market prices) **	0.5	3.9	-3.1	12.3	6.2
GDP per capita	-2.3	1.5	-5.1	10.1	4.2
Exports of goods and services	-1.4	12.8	15.3	36.4	8.3
** GDP at constant factor cost	1.7	4.4	-3.3	11.1	6.2

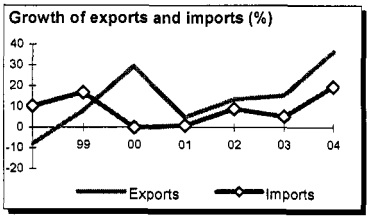


STRUCTURE of the ECONOMY

	1984	1994	2003	2004
(% of GDP)				
Agriculture	50.9	57.9	43.9	46.3
Industry	13.3	9.7	14.1	13.5
Manufacturing	6.1	4.4	5.6	5.3
Services	35.8	32.3	42.1	40.2
Household final consumption expenditure	77.0	81.7	76.4	81.9
General gov't final consumption expenditure	11.5	8.9	16.0	14.0
Imports of goods and services	13.9	14.1	29.5	32.6



	1984-94	1994-04	2003	2004
(average annual growth)				
Agriculture	2.7	2.0	-11.6	17.3
Industry	-3.9	5.2	5.5	6.8
Manufacturing	-5.5	3.8	0.7	5.4
Services	-0.3	5.5	4.2	5.8
Household final consumption expenditure	1.7	2.7	-3.7	14.7
General gov't final consumption expenditure	-3.2	11.2	1.0	0.4
Gross capital formation	-2.5	4.7	-5.8	3.4
Imports of goods and services	0.0	8.6	5.2	19.5



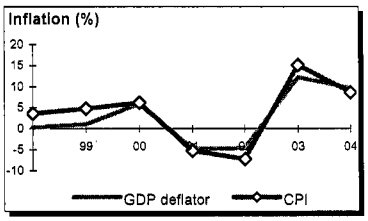
Note: 2004 data are preliminary estimates.

1/ All GDP figures are based on new SNA series.

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

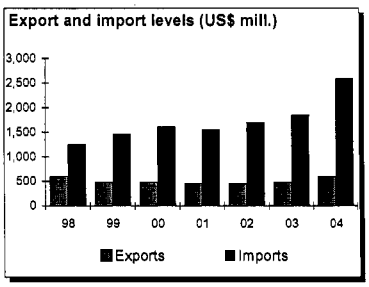
PRICES and GOVERNMENT FINANCE

	1984	1994	2003	2004
Domestic prices				
(% change)				
Consumer prices	-0.2	1.2	15.1	8.6
Implicit GDP deflator	-3.1	3.4	12.2	9.6
Government finance				
(% of GDP, includes current grants)				
Current revenue	14.4	12.1	21.3	18.4
Current budget balance	0.7	0.8	1.4	4.2
Overall surplus/deficit	-4.9	-6.0	-8.8	-6.6



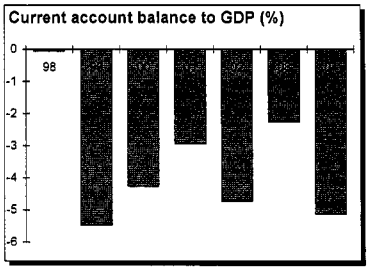
TRADE

	1984	1994	2003	2004
(US$ millions)				
Total exports (fob)	448	280	483	600
Coffee	285	158	165	224
Pulses and oilseeds	23	12	66	105
Manufactures	89	52	72	62
Total imports (cif)	1,026	915	1,856	2,587
Food	126	126	232	269
Fuel and energy	183	222	288	311
Capital goods	449	257	618	920
Export price index *(2000=100)*	137	110	122	81
Import price index *(2000=100)*	89	81	104	117
Terms of trade *(2000=100)*	153	136	117	69



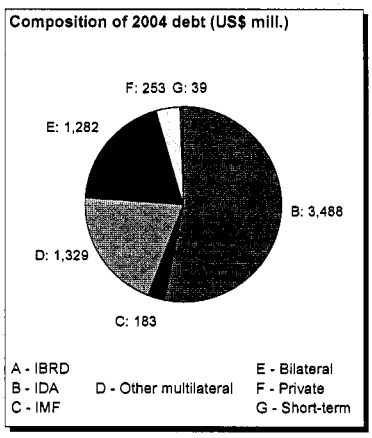
BALANCE of PAYMENTS

	1984	1994	2003	2004
(US$ millions)				
Exports of goods and services	612	556	1,139	1,498
Imports of goods and services	1,116	1,100	2,347	3,171
Resource balance	-504	-545	-1,207	-1,673
Net income	-19	-79	-66	-64
Net current transfers	147	532	1,095	1,238
Current account balance	-377	-92	-179	-499
Financing items (net)	334	306	441	903
Changes in net reserves	42	-214	-262	-405
Memo:				
Reserves including gold *(US$ millions)*	109	469	931	1,350
Conversion rate *(DEC, local/US$)*	2.1	5.8	8.6	8.6



EXTERNAL DEBT and RESOURCE FLOWS

	1984	1994	2003	2004
(US$ millions)				
Total debt outstanding and disbursed	4,220	10,063	7,187	6,574
IBRD	44	4	0	0
IDA	379	1,373	3,179	3,488
Total debt service	130	112	92	127
IBRD	8	4	0	0
IDA	5	19	26	36
Composition of net resource flows				
Official grants	205	638	1,135	..
Official creditors	509	201	205	232
Private creditors	117	-33	-6	71
Foreign direct investment (net inflows)	5	17	60	..
Portfolio equity (net inflows)	0	0	0	..
World Bank program				
Commitments	169	75	28	189
Disbursements	41	150	204	202
Principal repayments	7	13	9	13
Net flows	35	136	196	189
Interest payments	6	10	17	23
Net transfers	29	127	179	167



Annex 4:
Social Indicators

	Latest single year			Same region/income group	
	1975-80	1985-90	1998-04	Sub-Saharan Africa	Low-income
POPULATION					
Total population, mid-year *(millions)*	37.7	51.2	70.0	719.0	2,338.1
Growth rate *(% annual average)*	2.7	3.3	2.2	2.2	1.8
Urban population *(% of population)*	10.5	12.7	17.0	36.7	30.7
Total fertility rate *(births per woman)*	6.0	6.9	5.6	5.2	3.6
POVERTY					
(% of population)					
National headcount index	..	..	44.2	..	..
Urban headcount index	..	..	36.9	..	..
Rural headcount index	..	..	45.4	..	..
INCOME					
GNI per capita *(US$)*	..	..	130	600	510
Consumer price index *(1995=100)*	36	54	120	..	..
Food price index *(1995=100)*	34	50	134	..	..
INCOME/CONSUMPTION DISTRIBUTION					
Gini index	..	..	30.0	..	..
(% of income or consumption)					
Lowest quintile	..	..	9.1	..	..
Highest quintile	..	..	39.4	..	..
SOCIAL INDICATORS					
Public expenditure					
Health *(% of GDP)*	..	0.7	1.4	2.6	1.5
Education *(% of GNI)*	..	2.0	5.8	3.4	3.2
Social security and welfare *(% of GDP)*	..	..	..	..	..
Net primary school enrollment rate					
(% of age group)					
Total	..	23	57	64	78
Male	..	27	63	68	82
Female	..	20	52	60	76
Access to an improved water source					
(% of population)					
Total	..	25	22	58	75
Urban	..	80	81	82	89
Rural	..	16	11	45	69
Immunization rate					
(% of children ages 12-23 months)					
Measles	4	38	53	61	66
DPT	..	49	61	59	67
Child malnutrition *(% under 5 years)*	..	..	37	..	44

	Latest single year			Same region/income group	
	1975-80	1985-90	1998-04	Sub-Saharan Africa	Low-income
Life expectancy at birth *(years)*					
Total	42	45	42	46	58
Male	40	44	41	45	57
Female	44	47	43	46	59
Mortality					
Infant *(per 1,000 live births)*	143	131	112	101	79
Under 5 *(per 1,000)*	220	204	169	171	122
Adult (15-59)					
Male *(per 1,000 population)*	491	448	594	519	317
Female *(per 1,000 population)*	401	358	535	461	266
Maternal *(per 100,000 live births)*	..	..	850	24	538
Births attended by skilled health staff *(%)*	..	..	6	39	38

CAS Annex B5. This table was produced from the CMU LDB system.

Note: 0 or 0.0 means zero or less than half the unit shown. Net enrollment rate: break in series between 1997 and 1998 due to change from ISCED76 to ISCED97. Immunization: refers to children ages 12-23 months who received vaccinations before one year of age.

Annex 5:
Key Economic Indicators

Indicator	Actual				Estimate		Projected	
	2001	2002	2003	2004	2005	2006	2007	2008
National accounts (as % of GDP)								
Gross domestic product[a]	100	100	100	100	100	100	100	100
Agriculture	47	43	40	42	43	43	43	43
Industry	13	14	16	15	15	15	15	15
Services	40	42	45	43	41	42	42	42
Total Consumption	91	91	92	96	97	94	92	91
Gross domestic fixed investment	21	23	23	21	26	30	30	31
Government investment	7	9	9	10	11	15	15	16
Private investment	14	14	14	12	15	15	15	15
Exports (GNFS)[b]	12	13	14	15	17	17	19	19
Imports (GNFS)	24	28	30	33	39	42	40	41
Gross domestic savings	9	9	8	4	3	6	8	9
Gross national savings[c]	18	19	20	16	17	20	25	26
Memorandum items								
Gross domestic product (US$ million at current prices)	7988	7364	7946	9725	11064	12698	13379	14343
GNI per capita (US$, Atlas method)	130	120	110	130	150	160	180	190
Real annual growth rates (%, calculated from 2000 prices)								
Gross domestic product at market prices	7.9	0.0	-2.9	11.4	8.8	5.8	5.6	5.7
Gross Domestic Income	7.5	-1.4	-4.2	7.9	11.2	6.4	5.0	4.7
Real annual per capita growth rates (%, calculated from 2000 prices)								
Gross domestic product at market prices	5.5	-2.1	-4.9	9.3	6.9	3.8	3.6	3.6
Total consumption	4.0	-4.0	-4.7	9.2	9.5	1.8	0.2	1.9
Private consumption	11.3	-5.9	-5.4	11.3	10.2	-0.1	0.0	1.6
Balance of Payments (US$ millions)								
Exports (GNFS)[b]	979	983	1139	1498	1829	2207	2486	2756
Merchandise FOB	463	452	483	600	818	1044	1147	1223
Imports (GNFS)[b]	1936	2073	2347	3171	4367	5282	5415	5830
Merchandise CIF	1557	1696	1856	2587	3633	4511	4583	4927
Resource balance	**-957**	**-1091**	**-1207**	**-1673**	**-2538**	**-3075**	**-2929**	**-3074**
Net current transfers	775	783	1095	1238	1561	1868	2182	2380
Current account balance	-233	-347	-179	-499	-1013	-1223	-757	-699

Indicator	Actual			Estimate		Projected		
	2001	2002	2003	2004	2005	2006	2007	2008
Net private foreign direct investment	152	100	114	101	150	170	180	190
Long-term loans (net)	194	489	360	407	409	465	493	422
Official	434	594	205	232	219	214	156	72
Private	-240	-106	155	175	190	251	336	350
Other capital (net, incl. errors & ommissions)	-134	43	-33	396	667	389	336	306
Change in reserves[d]	22	-285	-262	-405	-212	199	-251	-219
Memorandum items								
Resource balance (% of GDP)	-12.0	-14.8	-15.2	-17.2	-22.9	-24.2	-21.9	-21.4
Real annual growth rates (YR00 prices)								
Merchandise exports (FOB)	0.4	13.3	3.5	29.0	8.8	14.3	9.9	10.1
Manufactures	42.8	-11.8	20.0	14.0	12.6	71.3	6.5	8.1
Merchandise imports (CIF)	-1.3	10.7	1.7	23.3	25.0	15.3	-0.2	7.4
Public finance (as % of GDP at market prices)[e]								
Current revenues	18.3	18.6	21.3	18.5	19.3	20.4	21.3	22.1
Current expenditures	15.7	16.8	19.8	14.3	13.6	13.8	13.4	13.3
Current account surplus (+) or deficit (-)	2.6	1.9	1.4	4.2	5.7	6.6	7.8	8.8
Capital expenditure	7.6	11.3	10.2	10.8	12.2	16.7	17.2	17.5
Foreign financing	4.5	9.6	7.4	4.9	4.1	4.5	4.5	4.5
Monetary indicators								
M2/GDP	37.0	42.3	43.2	40.3	42.2	42.2	42.6	42.9
Growth of M2 (%)	9.6	8.1	10.8	14.7	19.6	18.0	12.7	12.2
Private sector credit growth/total credit growth (%)	98.0	599.0	-39.4	10.2	30.1			
Price indices(YR00 =100)								
Merchandise export price index	82.4	71.1	73.3	70.6	88.5	98.8	98.8	95.6
Merchandise import price index	98.5	97.0	104.3	117.9	132.5	142.7	145.3	145.4
Merchandise terms of trade index	83.6	73.3	70.2	59.9	66.8	69.3	68.0	65.8
Real exchange rate (US$/LCU)[f]	43.3	42.9	45.4	43.3	47.2			
Real interest rates								
Consumer price index (% change)	-5.2	-7.2	15.1	8.6	6.8	10.8	6.0	6.0
GDP deflator (% change)	-4.9	-5.4	11.6	10.3	5.1	11.4	5.7	5.5

a. GDP at factor cost

b. "GNFS" denotes "goods and nonfactor services."

c. Includes net unrequited transfers excluding official capital grants.

d. Includes use of IMF resources.

e. Consolidated central government.

f. "LCU" denotes "local currency units." An increase in US$/LCU denotes appreciation.

Annex 6:
Key Exposure Indicators

Indicator	Actual 2001	2002	2003	2004	Estimate 2005	Projected 2006	2007	2008
Total debt outstanding and disbursed (TDO) (US$m)a *	5727	6526	7187	6574	6021	6061	6481	6869
Net disbursements (US$m)[a]	454	629	223	284	309			
Total debt service (TDS)(US$m)[a]	182	85	98	125	112	68	64	
Debt and debt service indicators (%)								
TDO/XGS[b]	559.1	626.5	597.2	397.3				
TDO/GDP	71.7	88.6	90.4	67.6	54.4	47.7	48.4	47.9
TDS/XGS	17.8	8.2	8.1	7.6				
Concessional/TDO	88.3	89.2	88.3	86.5				
IBRD exposure indicators (%)								
IBRD DS/public DS	0.0	0.0	0.0	0.0	0.0			
Preferred creditor DS/public DS (%)[c]	57.2	67.5	67.4	84.7	57.4	79.3	83.9	
IBRD DS/XGS	0.0	0.0	0.0	0.0				
IBRD TDO (US$m)[d]	0	0	0	0				
Of which present value of guarantees (US$m)								
Share of IBRD portfolio (%)	0	0	0	0				
IDA TDO (US$m)[d]	2151	2756	3179	3488				
IFC (US$m)								
Loans								
Equity and quasi-equity /c								
MIGA								
MIGA guarantees (US$m)								

* No data after 2004 from DRS (using calendar year), and filled with Art IV update which is based on fiscal year.

a. Includes public and publicly guaranteed debt, private nonguaranteed, use of IMF credits and net short-term capital.

b. "XGS" denotes exports of goods and services, including workers' remittances.

c. Preferred creditors are defined as IBRD, IDA, the regional multilateral development banks, the IMF, and the Bank for International Settlements.

d. Includes present value of guarantees.

e. Includes equity and quasi-equity types of both loan and equity instruments.

Annex 7: Selected Indicators of Portfolio Performance and Management
As of April 21, 2006

Indicator*	2003	2004	2005	2006**
Portfolio Assessment				
Number of Projects Under Implementation [a]	19	20	22	22
Average Implementation Period (years) [b]	2.9	3.5	3.2	4.0
Percent of Problem Projects by Number [a, c]	5.3	15.0	4.5	9.1
Percent of Problem Projects by Amount [a, c]	0.4	1.7	8.2	9.7
Percent of Projects at Risk by Number [a, d]	5.3	15.0	13.6	22.7
Percent of Projects at Risk by Amount [a, d]	0.4	1.7	13.5	14.1
Disbursement Ratio (%) [e]	27.8	27.9	24.7	13.4
Portfolio Management				
CPPR during the year (yes/no)	yes	no	yes	no
Supervision Resources (total US$ thousands)	$ 1,551	$ 1,864	$2,352	NA
Average Supervision (US$000/project)	$ 67	$ 85	$90	NA

Memorandum Item	Since FY 80	Last Five FYs
Proj Eval by OED by Number	50	9
Proj Eval by OED by Amt (US$ millions)	2,565.1	1,069.9
% of OED Projects Rated U or HU by Number	34.0	22.2
% of OED Projects Rated U or HU by Amt	21.3	15.0

a. As shown in the Annual Report on Portfolio Performance (except for current FY).
b. Average age of projects in the Bank's country portfolio.
c. Percent of projects rated U or HU on development objectives (DO) and/or implementation progress (IP).
d. As defined under the Portfolio Improvement Program.
e. Ratio of disbursements during the year to the undisbursed balance of the Bank's portfolio at the beginning of the year: Investment projects only.
* All indicators are for projects active in the Portfolio, with the exception of Disbursement Ratio, which includes all active projects as well as projects which exited during the fiscal year.
** Year to date.

Source: World Bank

Annex 8: IFC and MIGA Program for Ethiopia
As of April 21, 2006

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

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

Statement of IFC's Held and Disbursed Portfolio
As of April 21, 2006

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

Source: World Bank.

Annex 9: IDA Program Summary for Ethiopia
As of April 21, 2006

Fiscal year	*Project*	*US$ (M)*	*Strategic Rewards (H/M/L)*	*Implementation Risks (H/M/L)*
FY 2006	Protection of Basic Services	215	H	H
	Roads APL 2 Supplemental	87	H	M
	Rural Electricity Access Expansion	125	H	M
	Financial Sector Capacity Building	15	H	H
	Capacity Building for Agricultural Services	49	H	M
TOTAL FY06		**491**		
FY 2007	Productive Safety Nets APL 2		H	H
	Local Investment Grants		H	H
	Multisectoral HIV/AIDS 2		H	M
	Rural Electricity Access Expansion 2		H	M
	Tana Growth Corridor		H	H
	Irrigation and Drainage		H	M
	Roads APL 3		H	M
	Urban Development		H	H
TOTAL FY07		**400-550**		

Annex 10: Summary of IDA Non-Lending Services

As of April 21, 2006

Product	*Completion FY*	*Cost* (US$000)*	*Audience*[a]	*Objective*[b]
Recent completions				
Education Country Status Report	04	309	G, D, B, P	A, B, C
CEM	05	449	G, D, B, P	A, B, C
Health Country Status Report	05	299	G, D, B, P	A, B, C
Poverty Assessment	05	303	G, D, B, P	A, B, C
CAS Progress Report	05	12	G, D, B, P	E
CPPR	05	13	G, D, B	C, D
HIV/AIDS Community Involvement	05	28	G, D, B, P	A, B, C
Joint Budget and Aid Review FY05	05	NA	G, D, B	A, C, D
Water Strategy	05	121	G, D, B, P	A, B, C
Financial Markets Note	05	37	G, D, B	A, C
MDG Costing	05	298	G, D, B	A, C
Urban Housing	05	31	G, D, B	A, C
Environment Country Status Report	05	119	G, D, B, P	A, B, C
Empowerment	05	NA	G, D, B	A, C
PSIA (oil prices)	06	5	G, D, B	A, C
Telecom Fiscal Analysis	06	NA	G, D, B	A, C
Joint Staff Assessment Note (2nd APR)	06	NA	G, D, B, P	B, E
Underway				
Rural Development Assessment	06	515	G, D, B, P	A, B, C
Decentralized Service Delivery	06	166	G, D, B, P	A, B, C
CEM: Growth and Governance	06	NA	G, D, B, P	A, B, C
Institutional and Governance Review	06	334	G, D, B, P	A, B, C
Rural PER	06	34	G, D, B, P	A, B, C
Labor Market Study	06	273	G, D, B, P	A, B, C
Joint Budget and Aid Review FY06	06	23	G, D, B	A, C, D
Population	06	174	G, D, B	A, C
Rural Risk Management (Weather Insurance)	06	48	G, D, B	A, C
Value Chain Analysis	06	182	G, D, B, P	A, C
Tourism	06	46	G, D, B, P	A, C
Health Financing	06	54	G, D, B, P	A, B, C
Nutrition	06	0	G, D, B, P	A, B, C
Investment Climate Assessment update	06	30	G, D, B, P	A, B, C
Debt Sustainability Analysis	06	0	G, D, B	A, C
Soil Degradation	07	52	G, D, B	A, C
Urbanization Study	07	30	G, D, B, P	A, B, C
Planned/Proposed				
Joint Budget & Aid Reviews FY07	07	NA	G, D, B	A, C, D
Growth Corridors	07	120	G, D, B, P	A, B, C
Civil Society in Development Dialogues	07	NA	G, D, B, P	B, C
Gender	08	105	G, D, B, P	A, B, C
Poverty Update	07	150	G, D, B, P	A, B, C
Banking Sector Corporate Governance Review	07	105	G, D, B, P	A, B, C
Urban PSIA	07	60	G, D, B	A, B, C
Rural Investment Climate and Markets	07	60	G, D, B, P	A, B, C

a. (G) Government, (D) donor, (B) bank, (P) public dissemination.
b. (A) Knowledge generation, (B) public debate, (C) problem-solving, (D) donor coordination, (E) country strategy.
* Cost is actual cost for ongoing and completed activities, and budgeted for planned/proposed.

Annex 11: Status of Bank Group Operations (Operations Portfolio)

As of April 21, 2006

Closed Projects	74

IBRD/IDA (US$ Millions)	
Total Disbursed (Active)	809.9
of which has been repaid	0.0
Total Disbursed (Closed)	3205.2
of which has been repaid	484.2

Total Disbursed (Active + Closed)	4015.1
of which has been repaid	484.2
Total Undisbursed (Active)	873.6
Total Undisbursed (Closed)	8.9
Total Undisbursed (Active + Closed)	882.5

Active Projects

Project ID	Project Name	Last PSR Supervision Rating: Development Objectives	Last PSR Supervision Rating: Implementation Progress	Fiscal Year	Original Amount in US$ m: IDA	Original Amount in US$ m: GEF	Original Amount in US$ m: Cancel.	IDA Undisb. [a]	Expected and Actual Disbursements [b]: Orig.	Expected and Actual Disbursements [b]: Frm Rev'd
P000733	Agricultural Research & Training SIL (FY98)	S	S	1998	60.0			5.3	4.2	
P057770	Cultural Heritage LIL (FY02)	S	S	2002	5.0			3.9	2.5	
P050938	Decentralized Service Delivery Cap Bldg (FY03)	S	S	2003	26.2			22.1	18.5	
P073196	Demobilization & Reintegration ERL (FY01)	S	S	2001	170.6			30.5	24.5	2.9
P081773	Emerg Drought Recovery ERL (FY03)	S	S	2003	60.0			3.4	1.0	
P049395	Energy Access SIL (FY03)	U	S	2003	132.7			141.3	103.7	
P067084	Emerg Recovery & Rehabilitation ERL (FY01)	S	S	2001	230.0			32.9	14.2	-8.9
P050383	Food Security SIL (FY02)	S	S	2002	85.0			69.9	9.7	
P035147	GEF Medicinal Plants LIL (FY01)	MS	S	2001		1.9	1.0	0.3	1.2	
P069083	Global Distance Learning LIL (FY01)	MS	S	2001	4.9		3.1	0.6	4.2	0.2
P000756	Health Sector Dev (FY99)	S	S	1999	100.0			12.1	10.0	
P078458	Information and Comm Tech Asst Dev (FY05)	S	#	2005	25.0			23.2	5.1	
P069886	Multisectoral HIV/AIDS Proj (FY01)	S	S	2001	59.7			4.5	0.2	
P052315	Medicinal Plant Conserv LIL (FY01)	S	S	2001	2.6		1.0	0.2	0.9	
P075915	Pastoral Community Dev APL1 (FY03)	S	S	2003	30.0			11.5	-8.4	
P078692	Post Secondary Education SIL (FY05)	MS	MS	2005	40.0			36.5	9.8	
P050272	Private Sector Dev Cap Bldg (FY05)	MU	MU	2005	24.0			21.8	0.3	
P087707	Productive Safety Nets APL1 (FY05)	S	S	2005	70.0			24.2	3.9	
P074020	Public Sector Cap Bldg Prj (FY04)	S	S	2004	100.0			80.6	12.9	
P044613	Road Sec Dev Prgm APL1 (FY03)	MS	MS	2003	126.8			101.6	26.9	
P082998	Road Sec Dev Prgm APL2 (FY05)	S	S	2005	160.9			155.5	20.8	
P076735	Water Supply & Sanitation SIL (FY04)	S	S	2004	100.0			91.8	13.0	
P050342	Women Dev Initiatives LIL (FY01)	S	S	2001	5.0			0.4	0.0	-0.1
Total					1618.4	1.9	5.2	873.9	278.9	-5.8

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

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

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