I. Introduction and Context

A. Country Context

1. Ethiopia has experienced strong economic growth over the past decade and was amongst the fastest growing in the world. Real GDP growth averaged 10.9 percent in 2004-2014, which translated into an average per capita (in dollar terms) growth of 8.0 percent. This is equivalent to the annual per capita growth rate needed for Ethiopia to reach middle-income status by 2025. The rapid growth was driven by public infrastructure investment and supported by a conducive external environment. Growth was concentrated in services and agriculture with a recent impetus from construction, while contributions from manufacturing were low. However, potential effects of the current unrest in some regions of Ethiopia, as well as the recent drought pose downside risks to the economy.

2. Positive impacts from structural change for the period 2005 to 2013 were observed and it has potential to contribute much more to poverty reduction in the future. Economic growth and substantial improvements in the provision of safety nets and basic services have been important drivers of poverty reduction in the last decade, with each percent of growth reducing poverty by 0.55 percent. While there is a modest shift in labor from agriculture to services and construction, the structural change was not sufficiently inclusive.

3. The urban space plays a key role to advance structural change in Ethiopia and help reduce poverty. Urban areas are centers of innovation and industrial development. The urban economy is currently dominated by the manufacturing, construction, and services sectors with some unskilled labor...
migration from rural areas. Urban unemployment in the formal sector declined over the last decade, albeit slowly, and was reduced from 23 percent in 2004 to 17 percent in 2015. However, the rate of unemployment is large compared to the Sub-Saharan Africa (SSA) average of 11 percent. More policies are needed to translate the population growth dividend into employment generation activities in urban areas. Further agglomeration as a result of urbanization will also bring positive externalities that will encourage growth and help reduce poverty.

4. **Ethiopia has a federal, democratic government system**, established in the early 1990s, with nine autonomous states (‘regions’) and two chartered cities. Regional states have their own constitutions and are typically subdivided into administrative zones, which is a de-concentrated territorial level. Local governments, as the third tier, are established by regions according to their own Constitutions and governance structures. City administrations/Urban Local Governments (ULGs) and woredas (or rural local governments) are semi-autonomous local government entities, with legal status as corporate bodies with their own political leadership (council) and their own budget. ULGs are responsible for an extensive list of public service delivery functions, including those which they are responsible for executing on behalf of their regions.

**B. Sectoral and Institutional Context of the Program**

5. **Ethiopia has one of the fastest growing urban populations in the world**, with the number of people living in cities expected to nearly triple in the next two decades, from 15.2 million in 2012 to 42.3 million in 2037, growing at 3.8 percent a year. Analysis of the Ethiopia Urbanization Review (EUR) report indicates that the rate of urbanization will be even faster, at about 5.4 percent a year. That would mean a tripling of the urban population even earlier—by 2034, with 30 percent of the country’s people in urban areas by 2028. Ethiopia is going through a demographic transition. The labor force has doubled in the past 20 years and is projected to rise to 82 million by 2030, from 33 million in 2005. Well-functioning cities will be essential if Ethiopia is to exploit this demographic dividend. Cities already play an important role in the economy, contributing to 38 percent of GDP though employing only 15 percent of the total workforce, due primarily to the high productivity associated with sectors located mostly in urban areas. If managed proactively, urban population growth presents a huge opportunity to shift the structure and location of economic activity from rural agriculture to the larger and more diversified urban industrial and service sectors.

6. **However, the urban local government institutional systems and infrastructure have not kept pace with the rapid urbanization.** Despite progress over the last decade in building institutions, and providing infrastructure and services across all urban sectors, there is still much to do, even at today’s level of urbanization. Coverage for sanitation services is low, even by Sub-Saharan Africa standards, with a municipal sewerage system only in Addis Ababa, serving only 10 percent of the city’s population. As in many towns and cities in the developing world, Ethiopian cities struggle to manage solid waste, which is often dumped into open areas, endangering public health. Road density is below the African average, although higher in urban areas than the national average. Estimates from the Ethiopia Urbanization Review revealed that the average actual spending of Br 300 per urban resident (around US$17) would be required merely to maintain the existing level of services for existing urban residents, let alone meeting the needs of rapidly increasing urban populations and the existing gaps.

7. **Formal job creation is not keeping pace with urbanization.** Estimates indicate that due to the expected increase in the urban population, an additional 6 million urban jobs will be required between

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1 The Regions are Afar, Amhara, Benishangul-Gumuz, Gambella, Harari, Oromia, Somali, SNNPR (Southern Nations, Nationalities and Peoples), and Tigray. The chartered cities are Addis Ababa and Dire Dawa.
now and 2025, and over 17 million additional between now and 2035.² Although cities in Ethiopia offer migrants greater employment opportunities than rural economies, most jobs in the cities are in the informal or household sector and waged job opportunities in urban centers are not commensurate with migration. Of all urban households, 15 percent report having an unemployed adult; in Addis Ababa this rises to 23.5 percent.³ Thus, Ethiopia needs to aggressively pursue expanding job creation opportunities both in urban and rural areas. Global evidences also suggest that wage employment, rather than self-employment, leads to the emergence of a middle class in developing countries.

8. **Poor quality and often overcrowded living conditions are the major housing challenges experienced by urban households.** In general, housing quality in Ethiopia is lower than in neighboring countries. An estimated 70–80 percent of the urban population lives in what might be considered slums, according to a commonly accepted international definition, because the units lack durability, adequate space, access to safe water and sanitation, or security of tenure.⁴ Furthermore, in order to accommodate the expanded urban population the existing housing stock will have to increase by around 5 million dwelling units from now to 2025, and expand by a total of 13 million units to 2035.⁵

9. **Deficiencies in the urban institutions for municipal governance, municipal finance and land management underlie these gaps in infrastructure and services, housing and jobs.** Urban areas in Ethiopia have had functioning governments only since 2000, when proclamations to establish urban local governments were first issued. Combined with a commitment to fiscal decentralization, the proclamations are intended to give local governments more direct and transparent control over public spending. The objective has been to create and strengthen urban local governments that will ensure public participation in making choices and will enhance urban service delivery. The challenge has been to find ways to help urban local governments develop the capacities, incentives, and the financial resources needed to deliver infrastructure and services to residents effectively and efficiently. Strengthening urban institutions now while urbanization levels are low will be essential for urbanization’s success in Ethiopia.

10. **The Government of Ethiopia (GoE) acknowledges the important role of the urban sector in overall economic growth and wishes to invest in it.** The GOE’s 5-year development plan, currently the Second Growth and Transformation Program (GTP 2) (2015/2016 – 2019/2020), and the Ministry of Urban Development and Housing’s (MoUDH) Ethiopian Cities Sustainable Prosperity Goals (ECSPGs) (2015/16 – 19/2020) provide the framework for the urban strategic engagement going forward. The GTP promises doubling of GDP in the next five years, driven by industrial and manufacturing growth, while the ECSPGs aim to establish green growth, resilient and well governed cities that support Ethiopia’s transformation. The great majority of this rapid growth will have to take place in towns and cities. It has been estimated, as part of the preparation of the ECSPGs and GTP2, that cities’ capital investments will need to increase by over 3 fold during the next 10 years in order to enable achieving the goal of middle-income status by 2025.

**C. Relationship to CAS/CPF and Contribution to Higher Level Objectives**

11. **The ULGDP has been an integral element of the Country Partnership Strategy (CPS) for FY13-FY16 and contributes to meeting the World Bank’s twin goals of reducing extreme poverty and**

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³ Ethiopia Urbanization Review, The WBG, October 2015
boosting shared prosperity. The proposed Urban Institutional and Infrastructure Development Program (UIIDP or Program) directly supports pillar one of the CPS by financing urban infrastructure and services. These are essential to foster Ethiopia’s competitiveness. Urban infrastructure and services also improve the quality of urban dwellers’ lives by facilitating mobility and trade, reducing flooding and thus reducing damage to residential and businesses structures. It also creates positive health and productivity externalities through increased access to services such as drainage, water supply, sanitation and transport.

12. The proposed UIIDP will follow-up on the achievements in ULGDP II, also assist in creating more jobs and reducing economic vulnerability by continuing to encourage cities to use labor-intensive construction practices that generate significant numbers of jobs, especially for women, youth, and vulnerable people. Many cobblestone workers have now formed themselves into micro and small enterprises (MSEs), which are able to bid on and win contracts for other infrastructure projects. Cobblestone construction and other urban infrastructure assets generally use local materials, creating backward linkages to the local economy and reducing costs. The UIIDP will also directly contribute to the CPS’s objective of supporting good governance by providing resources on the basis of performance in participatory planning, financial management, procurement, maintenance, execution of infrastructure projects, and sustainable delivery of services.

13. The proposed UIIDP directly supports the GoE’s program, and is also aligned with the Government’s various strategies and goals. The previous phases of ULGDP were main instruments for the achievement of the goals and objectives of these government strategies and plans in the urban areas. Going forward, the UIIDP directly support the follow-on phase of the GoE’s program. UIIDP’s design will also align and directly link with the goals and strategies set in the ECSPGs and GTP2. The UIIDP proposes to cover a larger number of cities than the ULGDP. This phased scale-up approach was already envisaged at the inception of ULGDP and hence the UIIDP will further support the achievement of these GoE objectives.

II. Program Development Objective(s)

A. Program Development Objective(s)

14. The proposed Program Development Objective (PDO) is to enhance the institutional performance of participating urban local governments to develop and sustain urban infrastructure and services.

B. Key Program Results

15. The Program will produce institutional performance resulting in:

- enhanced citizen participation and engagement in ULG planning and budgeting, and gender focus;
- increased own source revenue at the ULG level;
- improved infrastructure, service delivery, O&M systems and job creation;
- improved efficiency and effectiveness in fiduciary management; and
- strengthened accountability and oversight systems.

16. In addition, UIIDP will also strive to elevate the performance standards and indicators to create “third generation” dimensions to the DLIs and results, and include new focus areas such as in urban resilience and local economic development. The UIIDP design would also review the options for further strengthening gender sensitive considerations and explore cross-sector collaborations where possible.
17. An independent annual assessment will be the main tool for assessing progress and achievements. The aggregate score of all the local government annual assessments will largely determine progress towards PDO. Previous experiences from the ULGDP found this tool to work well.

III. Program Description

A. PforR Program Boundary

Existing Government Program

18. The government established the Urban Institutional and Infrastructure Development Program (UIIDP) (the government program) as a follow-on phase of the ULGDP. The GoE started the Urban Local Government Development Program (ULGDP) in 2008 as a performance grant to urban local governments. This is the predecessor to UIIDP. Both government programs’ main thrust are to leverage institutional capacity at the urban local government level to improve service delivery and urban infrastructure. Its overall objective is to support improved institutional performance in the planning, delivery, and sustained provision of urban services and infrastructure by local governments.

19. Since the inception of the ULGDP, a programmatic approach was designed and hence the birth of UIIDP. To align with the MoUDH’s strategy, plans and the ECSPGs, the program was designed to be implemented in a phased approach. The intention is to roll-out the program to all cities which have autonomous urban administration status (with a responsibility of municipal and state functions), have city council and mayor, and a population more than 20,000 people (a total of 118 cities6). GoE also plans to gradually expand the scope of the federal and regional governments in capacity building and program administration.

20. The GoE and the World Bank have been working in partnership since the early 2000s to help Ethiopia’s urban local governments effectively meet their new responsibilities. The Bank has supported the government’s strategy through a series of projects7, and continued doing so in the first phase of ULGDP since its initiation in 2008 and the second phase of the program (ULGDP II) since 2014. The ULGDP and ULGDP II are jointly funded by the government and the World Bank, where the Bank contributed US$300 million and US$380 million respectively; while the counterpart funding was US$116 million and US$176.55 million respectively. For this PforR, the scope and boundaries will be identical to the scope and boundaries of the new government UIIDP program (see Table 1). Thus, the proposed UIIDP is supporting ULGs with financing provided partly by the World Bank and partly by government8.

Table 1: Government program and World Bank support

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<tr>
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</thead>
<tbody>
<tr>
<td>Government program (program)</td>
<td>ULGDP</td>
<td></td>
<td>UIIDP</td>
</tr>
<tr>
<td>World Bank Program (Program)</td>
<td>ULGDP (IPF)</td>
<td>ULGDP II (PforR)</td>
<td>UIIDP (PforR)</td>
</tr>
</tbody>
</table>

6 Of the 118 cities, 44 are existing cities in the parent ULGDP II; 41 cities had population above 20,000 as at CSA Census 2007; and another 33 cities, as at CSA Census 2007 had population below 20,000 and they only achieved population above 20,000 at the July 2013 CSA Estimates.
7 Capacity Building for Decentralized Service Delivery project (2003) and the Public Sector Capacity Building program (2004).
8 Program (with a capital P) refers to the PforR program, while program (with a lowercase p) refers to the government’s program.
Key Results of ULGDP and ULGDP II Achieved

21. The ULGDP was completed in December 31, 2014, and fully disbursed its budget. The second phase – ULGDP II is due to close in 31 December 2019. So far, ULGDP II made three round of disbursements and they were all above original estimates due to better-than-average performance by the cities. In total, ULGDP II has disbursed US$228.91 million (or 67.28%). (See Table 2 below for designed target disbursement versus actual disbursement.) This trend is expected to continue in the remaining two years as cities continue to improve their performance.

Table 2: Disbursements under ULGDP II

<table>
<thead>
<tr>
<th></th>
<th>Forecast (US$ mil)</th>
<th>Actual (US$ mil)</th>
<th>Date</th>
<th>% Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year 1 (FY 2015)</td>
<td>60.74</td>
<td>63.23</td>
<td>Nov-14</td>
<td>4.10%</td>
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<tr>
<td>Year 2 (FY 2016)</td>
<td>78.81</td>
<td>82.46</td>
<td>Jun-15</td>
<td>4.63%</td>
</tr>
<tr>
<td>Year 3 (FY 2017)</td>
<td>80.81</td>
<td>90.02</td>
<td>Jun-16</td>
<td>11.40%</td>
</tr>
<tr>
<td>Total/Average</td>
<td>220.36</td>
<td>235.71</td>
<td></td>
<td>6.97%</td>
</tr>
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</table>

22. Due to the better-than-expected performance of cities in ULGDP II, there is a need to replenish the funding resource pool. The disbursement system for DLIs 1, 2 and 3 (targeted at ULGs) is designed to be scalable and rewards actual performance (i.e. if the ULGs perform better than expected, they will receive additional funds). The actual additional disbursements under ULGDP II for the first three years were US$11,366,198 for DLI 2 and US$9,892,998 for DLI 3, making a total of US$21,259,196. The projected additional disbursements for the remaining 2 years, assuming the 44 cities maintain the current performance trend, is around US$19.5 million. Accordingly, the total projected additional funding required for the existing 44 cities to complete the 5 years under ULGDP II is approximately US$40.8 million. (It is expected that DLI 4-9 will perform more or less as expected and no additional funds are required or significant savings expected for these regional and MoUDH DLIs.) As the UIIDP is closely related to its predecessor, ULGDP, this shortfall is expected to be met through funds availed in the first year of UIIDP.

23. Significant achievements have been made under the program through the two phases. This is reflected through the substantial institutional strengthening achieved, direct jobs created, enhanced implementation of the capital investment plans of ULGs, urban infrastructure and services improved and strengthening of the operations and maintenance, creating visible impacts on the ground across the country in the 44 participating cities.

24. The program introduced several firsts in the country – the conduct of value for money audits, procurement and environment and social audits of local governments. Institutional capacity in the participating cities has made impressive improvements in their planning, revenue mobilisation, asset management, budgeting, financial management, investment planning, procurement, and project execution. While prior to ULGDP cities did not systematically consult with citizens in determining priorities, all program cities now have regular citizen consultation practice; in nearly all ULGDP cities the number of citizens participating in planning forums has more than doubled since the start of the program. Similarly, financial accounting and management have improved. All 44 cities have transitioned from manual to computerized systems for generating financial reports. At the beginning of the program, none of the cities have timely audit, and now all 44 do. Further, since enrolling in the program, all ULGs were found not to have audit backlogs. Revenue enhancement plans are in place in all cities. Asset management plans are enabling the cities to plan for new investments and budget for operations and maintenance needs in a
more systematic and comprehensive way. Cities are now systematically implementing maintenance programs. Own source revenues (OSR) are increasing in many cities, with 34 of the 44 cities increasing it by more than 10% in FY15, although overall levels remain low and have much room for improvement.

25. These huge leaps made in institutional strengthening and urban governance formed the bedrock in enabling better infrastructure and services delivery in cities. ULGs participating in the ULGDP have improved their capacity to deliver infrastructure and services and to maintain the actual assets. Before the ULGDP, participating ULGs had mainly dirt roads and few infrastructure and services. Under phase 1, around 2.6 million people have benefited from the infrastructure and services financed under ULGDP. Some 670 kilometers of roads and 588 kilometers of drainage system, 171 latrines and 110 community water points have been constructed, with 29,000 people given access to improved water sources. Under phase 2, the direct program beneficiaries totaled more than 3 million. Over the last 2.5 years under ULGDP II, 498 km of urban gravel roads were built or rehabilitated; 719 km of cobblestone roads were constructed in the 44 cities; more than 100 hectares of public parks and greenery were developed; over 3,700 hectares of land were serviced for industry, MSEs and housing; and numerous drainage systems, landfills, flood protection walls, public toilets, street lightings were implemented in most of the cities. Furthermore, the annual jobs directly created by ULGDP has increased from 60-80,000 per year under ULGDP I to around 140,000 under ULGDP II, with a continued increase due to investments in labor intensive infrastructure.

26. On the ground, communities in the participating cities expressed high appreciation of the program. Cobblestone streets and drainage systems built with the program funds have become visible ULGDP trademarks. Communities appreciate these so much that they are now contributing their own funds to scale-up their construction, and have even spurred creations of SMEs locally to take on the construction work. The roads have led to improved access and mobility, and together with drainage improvements, reduced flooding, enhanced public health, as well as improved business/trading environment. In addition, the cities became more livable; neighborhoods are being revitalized, increasing property values and tax revenues. These infrastructure and services improvement are also key to local job generation (with the cobblestone construction benefitting largely youth and women) and assisted in the economic and social development of the cities, regions and country as a whole. (Further details on ULGDP II are included in Annex 3.)

IV. Initial Environmental and Social Screening

B. Environmental and Social Systems Aspects

27. The scope of physical investments under the Program is expected to include urban roads, integrated infrastructure and land services, sanitation, solid waste management, water supply, and urban drainage in the urban local governments; these are expected to have a positive impact on the environment. The Program will avoid including sub-projects that are likely to have significant environment and social risks. One of the criteria in the choice of specific infrastructure investments under the Program will be its associated or likely social and environmental effects, particularly risks associated with potential loss or conversion of natural habitats; effects on physical and cultural resources; potential pollution or other project externalities; and changes in land or resource use. The program will also consider social effects such as nature/scale of involuntary resettlement or land acquisition required; potential impacts on vulnerable communities; changes in resource access and impacts on Indigenous Peoples.

28. The program is expected to involve multiple jurisdiction and implementing partners with varying capacity to implement regulations and procedures. The implementing capacity and commitment of various cities will be assessed during Program preparation. The ULGDP II cities have more implementation experience (some since 2008) in using the Environmental and Social Management
Framework (ESMF) and the Resettlement Policy Framework (RPF) that were developed consistent with the Bank’s safeguards policies. These were used by local governments in implementing infrastructure and services including roads, solid waste management (landfills), water supply, urban drainage, market sheds and bus terminals. The cities have continued to use practices developed earlier which include screening of all infrastructure investments for environment and social risks, approval by the Regional Environmental Protection Agency (REPA) of relevant safeguard instruments (EIAs, environmental management plans, and resettlement action plans (RAPs), and regular site visits.

29. The experience of the government program shows mixed institutional capacity. While some of the cities are able to use the prepared safeguards instruments properly, others show poor implementation performance in the use of the approved tools and approaches. This lesson will be incorporated in UIIDP by proactively fostering collaboration with participating cities in the use of similar risk management tools and approaches which will be incorporate in the Program design and further, in the program action plan, if needed.

30. Environmental and social monitoring is expected to be key in successful Program execution. Thus, GoE will ensure that safeguards supervision will be adequately funded and reinforced by federal, regional and participating city governments. Under the UIIDP environmental and social safeguard implementation is expected to be reviewed and monitored by Regional Environmental Protection Agencies, and with the City level safeguards focal persons. Furthermore, environmental and social specialist(s) will be maintained at the Regional and City levels to provide additional technical assistance on environmental and social matters, including development of a functional grievance redress mechanism (GRM) to assist in handling complaints and grievances in a more systematic way.

31. An Environmental and Social Systems Assessment (ESSA) will be undertaken to review the changes to the existing systems of for the execution of the Program in terms of capacity to plan and implement effective measures for environmental and social impact management. The assessment will build on the one conducted for ULGDP II in 2014. Furthermore, the update will take into account the ESSA conducted for the ESPES and other efforts under the SPL program to build capacity in environmental and social safeguards at the local level. More specifically, the ESSA will review any changes and the progress made over the last few years in the government’s regulatory and administrative framework and the capacity of the relevant implementing agencies, including local governments, to implement these. Consideration will include previous relevant experience in the sector, compared against the environmental and social effects that are likely to be associated with the Program.

32. The Bank team also conduct field level assessments in selected regions and ULGs, including a sample of the new cities proposed to be covered. On the basis of the results of the assessment, it will revise the Program Action Plan (PAP) in consultation with the stakeholders. The update will give special emphasis to (i) the institutional arrangement and linkages for the implementation of agreed safeguards actions, (ii) potential impacts of any new activities to be considered in the proposed UIIDP, and (iii) the challenges and opportunities for improved environmental and social risk management in the ULGs. The ESSA will inform the design of the UIIDP with regard to any possible DLI on safeguards and/or additional actions in the PAP. The draft systems assessment will be disclosed to the public prior to appraisal.

33. Citizens Engagement and Social Accountability: The recent APA of the ULGDP II established that systems are in place and communities are engaged in the capital investment planning and the implementation of projects. It is noted that communities are informed about project milestones, and various documents and audio and videos have been produced to ensure these. The program has indicators that track the progress of ULGs and it was confirmed that ULGs are doing well in this area. The preparation of UIIDP will involve the MoUDH and ULGs in further understanding social accountability
mechanisms and identifying ways to strengthen existing citizen’s engagement mechanisms through established channels. It will also focus on building up the citizen engagement processes and systems in the new cities.

V. Tentative financing

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